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Supreme Court, U.S.
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No. 86-

IN THE

Supreme Court of the United States

October Term, 1986

MARATHON OIL COMPANY,
an Ohio corporation,

Petitioner,

v.

UNITED STATES OF AMERICA; UNITED STATES DEPARTMENT OF THE INTERIOR; DONALD HODEL, Secretary of the Interior; ESTHER WUNNICKE, Commissioner of the Department of Natural Resources, State of Alaska; COOK INLET REGION, INC., an Alaska corporation,

Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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A. NINTH CIRCUIT OPINION AND JUDGMENT ISSUED JULY 24, 1986

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARATHON OIL COMPANY, an Ohio corporation, *Plaintiff-Appellant,*	No. 85-3800 DC. No. A83-208 Civil
vs.	
UNITED STATES OF AMERICA; UNITED STATES DEPARTMENT OF THE INTERIOR; DONALD HODEL, Secretary of the Interior; ESTHER WUNNICKE, Commissioner of the Department of Natural Resources, State of Alaska; COOK INLET REGION, INC., an Alaska corporation, *Defendants-Appellees.*	
COOK INLET REGION, INC., an Alaska corporation, *Counterclaimant,*	
vs.	OPINION
MARATHON OIL COMPANY, an Ohio corporation, *Counterdefendant.*	

Appeal from the United States District Court
for the District of Alaska
James M. Fitzgerald, District Judge, Presiding
Argued and Submitted February 14, 1986
Seattle, Washington

Before: WRIGHT and WALLACE, Circuit Judges,
and LEGGE,* District Judge.

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* Honorable Charles A. Legge, United States District Judge, Northern District of California, sitting by designation.

WALLACE, Circuit Judge:

Marathon Oil Company (Marathon) appeals from the district court's dismissal of its claims and from the entry of summary judgment and an injunction on the government's counterclaim that required it to pay production royalties on federal oil and gas leases based on a net back valuation formula. We have jurisdiction pursuant to 28 U.S.C. § 1292(a)(1), and we affirm.

I

Marathon owns a 50% working interest in certain federal oil and gas leases in the Kenai Field Unit in Alaska. The leases require Marathon to pay 12½% royalty on the reasonable value of production from the leased lands "computed in accordance with the Oil and Gas Operating Regulations (30 C.F.R. Pt. 221) [now codified in relevant part at 30 C.F.R. § 206.103 (1985)]." The statutory authorization for promulgating the Oil and Gas Operating Regulations is found at 30 U.S.C. § 226(c). The government, the State of Alaska, and Cook Inlet Region, Inc. (Cook Inlet) are each entitled to receive a percentage of the royalties. Marathon transports about 16% of its share of the gas produced in the Kenai Field Unit to a liquefied natural gas plant owned by Marathon and Phillips Petroleum Company. After the gas is reduced to a liquid state, Marathon transports the liquefied natural gas in tankers to Japan where it is sold. Marathon computed royalties on the liquefied natural gas sold in Japan based on the price paid for Kenai Field Unit gas under a long-term contract it had to sell unliquefied gas to the Alaska Pipeline Company.

In 1977, the United States Geological Survey (USGS), which was responsible for managing federal oil and gas leases, concluded that the royalty value for the liquefied natural gas sold in Japan should reflect its sales price in Japan less expenses. Marathon objected to USGS's proposed net back

valuation formula. In an effort to resolve the dispute, an agreement was entered into that required Marathon to pay royalties as computed according to the "Phillips formula." The Phillips formula required Marathon to pay royalties based on 36% of the price received in Japan for the liquefied natural gas, less certain adjustments. The agreement was to remain in effect until market conditions changed or applicable laws necessitated revision of the valuation method.

In 1983, the Mineral Management Service (the Service), which succeeded USGS as the government agency responsible for managing the involved leases, notified Marathon that it intended to redetermine the reasonable value of production of the Kenai gas delivered to the liquefied natural gas plant. The Service told Marathon that the basic net back approach as incorporated into the Phillips formula was sound, but that certain adjustments needed to be made to reflect current costs and prices. The new royalty valuation formula required subtraction of certain actual costs, instead of a fixed percentage, from the sales price of the liquefied natural gas.

Although it was not required to do so by statute, the Service held a public hearing at which Marathon appeared and was permitted to make comments, to state opinions, and to provide statements of facts concerning the new royalty valuation formula. The Service designated a 30-day period following the hearing for comments in which all interested parties could provide additional information or make additional arguments in favor of their position. After the 30-day period expired, the Service issued an order directing Marathon to pay royalties based on the revised royalty valuation formula. Marathon appealed the order to the Director of the Service, alleging that the Service had repudiated the settlement agreement entered into by Marathon and USGS. In addition, Marathon ceased paying royalties based on the agreed-to Phillips formula and began computing royalties based on the long-term contract price paid to the Alaska Pipeline Company.

The Service issued a second order directing Marathon to compute royalties according to the Phillips formula from the date Marathon began computing royalties based on the terms of the long-term contract to the effective date of the order requiring compliance with the revised royalty valuation formula. Marathon did not comply with this second order either. The Department of the Interior (the Department) then issued a third order, at the direction of the Secretary of the Interior (the Secretary), directing Marathon to comply with the previous two orders.

Marathon filed a declaratory relief action, 28 U.S.C. § 2201, in district court seeking, among other things, a determination of the proper method of valuing the royalty for natural gas which was liquefied and sold in Japan. The government sought to have Marathon's claims dismissed and counterclaimed to enforce the previous orders and to recover unpaid royalties. The government requested a preliminary injunction to compel Marathon to comply with the Service's orders, and moved for summary judgment. The district court deferred ruling on the government's request for a preliminary injunction until the motion for summary judgment was heard. The district court then granted the government's motion for summary judgment on its counterclaim, dismissed Marathon's claims and issued an injunction ordering Marathon to comply with the orders. The district court retained jurisdiction, however, until an accounting to determine royalties due from Marathon had been completed. A more extensive statement of the facts appears in the district court opinion, *see Marathon Oil Co. v. United States*, 604 F. Supp. 1375, 1376-78 (D. Alaska 1985) (*Marathon*).

II

Marathon's complaint requested a declaratory judgment to the proper method of valuing production for royalty purposes. The Declaratory Judgment Act, 28 U.S.C. § 2201, however, does not create an independent jurisdictional basis for actions

in federal court. *See Fiedler v. Clark*, 714 F.2d 77, 79 (9th Cir. 1983) (per curiam); *Alton Box Board Co. v. Esprit de Corp.*, 682 F.2d 1267, 1274 (9th Cir. 1982). Therefore, we must decide whether the administrative orders that required Marathon to pay production royalties based on the net back valuation formula were final agency actions reviewable by the district court pursuant to the jurisdictional grant of section 10(c) of the Administrative Procedures Act, 5 U.S.C. § 704. *See FTC v. Standard Oil Co.*, 449 U.S. 232, 238 (1980).

The Supreme Court has instructed us to interpret "pragmatically the requirement of administrative finality, focusing on whether judicial review at the time will disrupt the administrative process." *Bell v. New Jersey*, 461 U.S. 773, 779 (1983). The third order issued by the Department, which required Marathon to comply with the previous two orders issued by the Service, contained the following language: "This order is issued at the direction of the Secretary and, accordingly, constitutes a final decision by the Department pursuant to 43 C.F.R. Section 4.5(a)." Section 4.5(a) indicates that the Secretary retains the power to take jurisdiction "at any stage of any case before any employee or employees of the Department . . . and render the final decision in the matter." 43 C.F.R. § 4.5(a) (1985). The Secretary exercised this power and issued a final decision that required Marathon to comply with the previous two orders. Therefore, the district court had jursidiction [sic] pursuant to section 10(c) of the Administrative Procedures Act to act on Marathon's claim for declaratory judgment and to decide the validity of the orders.

III

That does not answer the question, however, of whether we have jurisdiction to review the district court's entry of summary judgment, partial dismissal and injunction. Section 1292(a)(1) provides us with jurisdiction to review "inter-

locutory orders of the district courts of the United States . . . granting . . . injunctions." After concluding that the Service's orders were appropriate and that the government was entitled to summary judgment and dismissal of Marathon's claims as a matter of law, the district judge issued an injunction that required Marathon to comply with the orders. The entry of summary judgment and partial dismissal, however, was not a final judgment within the meaning of 28 U.S.C. § 1291 because the district court retained jurisdiction to conduct an accounting. *See Warehouse Restaurant, Inc. v. Customs House Restaurant, Inc.*, 726 F.2d 480, 481 (9th Cir. 1984); *Hain Pure Food Co. v. Sona Food Products Co.*, 618 F.2d 521, 522 (9th Cir. 1980) (per curiam). Therefore, the injunction, although permanent in nature, is an interlocutory order appealable under section 1292(a)(1). *See Smith v. Eggar*, 655 F.2d 181, 184-85 (9th Cir. 1981); *Ackerman-Chillingworth, Division of Marsh & McLennan, Inc. v. Pacific Electrical Contractors Association*, 579 F.2d 484, 489 (9th Cir. 1978), *cert. denied*, 439 U.S. 1089 (1979); 16 C. Wright, A. Miller, E. Cooper & E. Gressman, *Federal Practice and Procedure* § 3924, at 67-68 (1977).

Although we have jurisdiction to review the issuance of the injunction, we must also consider whether we have jurisdiction to review the summary judgment and partial dismissal. Marathon contends that we may do so based on the jurisdictional grant of section 1292(a)(1). "[A]n order granting or refusing an injunction brings before the appellate court the entire order, not merely the propriety of injunctive relief, and [we] may decide the merits of the case and order dismissal of the action." *Barrett v. Smith*, 530 F.2d 829, 830 (9th Cir. 1975) (per curiam) (citation omitted), *cert. denied*, 425 U.S. 977 (1976). As a general rule, however, we concern ourselves "only with the order from which the appeal is taken, " *Yamamoto v. Omiya*, 564 F.2d 1319, 1325 n.11 (9th Cir. 1977), and review other issues only if they are "inextricably bound up" with the injunction. *Phoceene Sous-Marine, S.A. v. U.S. Phosmarine,*

Inc., 682 F.2d 802, 805 (9th Cir. 1982); *see Fentron Industries, Inc. v. National Shopmen Pension Fund*, 674 F.2d 1300, 1304 (9th Cir. 1982) (*Fentron*) (review of injunction necessarily involved deciding substantive issues).

In *Smith v. Vulcan Iron Works*, 165 U.S. 518 (1897) (*Smith*), the Supreme Court entertained a like jurisdictional challenge under very similar facts. In *Smith*, the district court entered an interlocutory judgment that a patent was valid, issued an injunction to prohibit infringement of the patent, and referred the case to a master to make an accounting of damages and profits. The defendant appealed, claiming that the patent was invalid and that it had not been infringed. The plaintiff moved to limit consideration on appeal to the propriety of the injunction. We concluded that the patent was invalid, that it had not been infringed, and reversed the interlocutory judgment of the district court. *Id.* at 518. The plaintiff contended before the Supreme Court that we erred in deciding the merits based on a jurisdictional grant to review the propriety of the injunction. The Court, however, concluded that the appeal from the interlocutory permanent injunction permitted us to decide the case upon its merits. *Id.* at 525. We have reached the same conclusion on a number of occasions. *See, e.g., Fentron*, 674 F.2d at 1304; *Long v. Bureau of Economic Analysis*, 646 F.2d 1310, 1317-18 (9th Cir.) (per curiam), *vacated on other grounds*, 454 U.S. 934 (1981).

Although we have expressed reluctance to review a denial of summary judgment when reviewing a preliminary injunction, *see Sierra On-Line, Inc. v. Phoenix Software, Inc.*, 739 F.2d 1415, 1421 (9th Cir. 1984), due in part to the fact that our review of a preliminary injunction is necessarily limited, *see Sports Form, Inc. v. United Press International, Inc.*, 686 F.2d 750, 752-53 (9th Cir. 1982), we see no need to refrain from determining the validity of the orders in this case. The injunction here is a permanent rather than a temporary in-

junction. The legality and enforceability of the orders is inextricably bound up with the injunction that requires Marathon to comply with the orders. The district court has completed its consideration of the liability issue, retaining jurisdiction only for an accounting of damages. We conclude, therefore, that we have jurisdiction pursuant to section 1292(a)(1) to review the summary judgment and partial dismissal and that we should do so in this case.

IV

Marathon contends that the district judge erred in granting the government's motion for summary judgment and the resultant dismissal of Marathon's claims because the net back valuation formula adopted by the Service is contrary to the Mineral Lands Leasing Act, 30 U.S.C. §§ 181-287 (the Act), to the regulations and rulings issued pursuant to the Act, and to the terms of Marathon's leases. Marathon does not challenge the propriety of the injunction other than to argue that it was improper because it is based upon a wrongly decided summary judgment. Therefore, we need address only the correctness of the district court's entry of summary judgment.

We review the district judge's entry of summary judgment de novo and will affirm if, after reviewing the record in the light most favorable to the non-moving party, there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *See Continental Casualty Co. v. City of Richmond,* 763 F.2d 1076, 1078-79 (9th Cir. 1985); *Nevada v. United States,* 731 F.2d 633, 635 (9th Cir. 1984).

The fact that we review the summary judgment de novo, however, does not mean that we review de novo the Service's decision to adopt the net back valuation formula and to issue the compliance orders. *See Cranston v. Clark,* 767 F.2d 1319, 1320 (9th Cir. 1985); *Kidd v. Department of Interior, Bureau of Land Management,* 756 F.2d 1410, 1411-12 (9th Cir. 1985).

De novo review in this case means only that we view the case from the same position as the district court. In section 10(e) of the Administrative Procedures Act, 5 U.S.C. § 706, Congress established a deferential standard of review of agency decisions. This is especially true where, as here, the agency action being reviewed is not pursuant to agency rule making authority, 5 U.S.C. § 553, or action based on a public adjudication hearing, 5 U.S.C. §§ 556, 557. In the case before us, the informal agency decision in issue will not be reversed unless it is determined to be arbitrary, capricious, an abuse of discretion, or contrary to law. 5 U.S.C. § 706(2)(A); *see Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 413-14 (1971) (*Overton Park*). We must determine only whether a clear error of judgment has occurred and whether the agency based its decision upon consideration of relevant factors. *See Overton Park*, 401 U.S. at 416. Thus, we do not review the Service's decision to adopt the net back formula under the substantial evidence standard of section 706(2)(E) because the Service did not engage in rulemaking or base its decision on a public adjudicatory hearing. *Id.* at 414.

The agency's interpretation of the applicable statute is entitled to substantial deference, particularly if the agency is charged with administering the statutes. *See Chevron, U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837, 843-45 (1984). Furthermore, an agency's interpretation of its regulations is " 'of controlling weight unless it is plainly erroneous or inconsistent with the regulation[s].' " *Udall v. Tallman*, 380 U.S. 1, 16-17 (1965), *quoting Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945); *see Hawaiian Electric Co. v. EPA*, 723 F.2d 1440, 1447 (9th Cir. 1984).

A.

We have reviewed the district judge's well-reasoned opinion in this case. *See Marathon*, 604 F. Supp. 1375. The district judge applied the appropriate standard of review and concluded as a matter of law that the net back valuation formula

did not violate the Act, that the formula was not contrary to agency regulations or rulings, and that the formula was not inconsistent with the terms of Marathon's leases. We agree. This is not the first time we have concluded that it is not unreasonable for the Secretary to use a net back or net realization formula to compute the value of production for royalty purposes. *See Continental Oil Co. v. United States,* 184 F.2d 802, 820-21 (9th Cir. 1950); *see also Ashland Oil, Inc. v. Phillips Petroleum Co.,* 554 F.2d 381, 387-88 (10th Cir. 1977) (en banc) (government has often used a work back method to determine royalties due), *cert. denied,* 434 U.S. 921 and 434 U.S. 968 (1977); R. Hemingway, *The Law of Oil and Gas* § 7.4, at 355 (1983) (proceeds language requires royalty computation based on sales price rather than market or field price). For the reasons so ably expressed by the district judge in discussing the issues before him, *Marathon,* 604 F. Supp. at 1380-90, we conclude that he did not err in upholding the validity of the net back valuation formula used in this case.

B.

Marathon has raised several additional arguments not addressed by the district judge. Marathon contends that the net back valuation formula is contrary to previous agency rulings. The district judge held that the Duletsky memorandum and the royalty payment order to Union Oil Company do not preclude application of the net back valuation formula. *See* 604 F. Supp. at 1383-84, 1389. In addition, however, Marathon contends, that the Notice to Lessees and Operators of Federal and Indian Onshore Oil and Gas Leases (NTL-5) demonstrates that a net back formula is contrary to agency regulations. Although Marathon relied on NTL-5 to support its position in the district court, the district judge did not specifically refer to it in his opinion. Consequently, we now consider the significance of NTL-5 to this case.

Section V.C. of NTL-5 states that "[r]oyalty generally will be computed on the volume and value of marketable production at the lease, communitized area, or unit participating area

boundary." Marathon relies on this language to argue that the value of production for royalty purposes should be determined at the well site. Such an argument, however, ignores critical language in section V.A., which states that "[u]nder no circumstances will royalty be computed on less than the gross proceeds accruing to the lessee or operator from the sale of leasehold production." Similar references to "the price received by the lessees" for the gas produced can be found in sections I.A.1 and II.B.1. We conclude that the implicit exception in section V.C. created by the word "generally" becomes operative when the use of the wellhead price to calculate royalties would result in a royalty being computed on less than the gross proceeds received by the lessee from the sale of the produced gas. Thus, the net back valuation formula does not conflict with language of NTL-5.

Marathon also argued before the district court and contends before us that the net back valuation formula fails to consider all of the costs incurred in manufacturing and selling liquefied natural gas and that the potential imposition of an 8% reasonable rate of return is arbitrary and unjust. We conclude that these issues are not ripe for judicial review. The district court retained jurisdiction to conduct an accounting in order to determine the royalties due from Marathon. *Marathon,* 604 F. Supp. at 1390. Marathon has filed an accounting with the district court that raises a number of these same issues. The Service has reviewed Marathon's accounting and filed objections to the calculation procedures and factors used by Marathon to complete the accounting. The government and Cook Inlet contend that review of the accounting aspects of the net back valuation formula is premature and that we should wait until the district court has had an opportunity to prepare a more complete record. Because many of these same objections are presently being considered by the district court and because the factual record on these issues is not well developed, we decline to consider the merits of Marathon's objections to the specifics of the net back valuation formula at this time.

C.

Marathon also contends that the district judge erred in granting the government's motion for summary judgment because there are genuine issues of material fact as to whether natural gas and liquefied natural gas are substantially similar, whether the Service waived administration of one of the involved leases held by Cook Inlet, and whether Cook Inlet improperly influenced the Service's decision to adopt the net back valuation formula.

1.

The district court concluded that liquefied natural gas is not "distinct from the natural gas at the wellhead" but rather "is natural gas that has been cooled for purposes of storage or shipment." 604 F. Supp. at 1386. Marathon contends that the district judge's determination that liquefied natural gas is essentially the same as natural gas required him to resolve disputed issues of material fact. We do not decide this issue because it was unnecessary for the district judge to make a finding of fact concerning the nature of liquefied natural gas. The deferential standard of review of informal agency decisionmaking requires only that we "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Overton Park*, 401 U.S. at 416.

Marathon first argued that liquefied natural gas is a manufactured product separate from natural gas in response to the USGS's request for information concerning the gross proceeds received from the sale of the liquefied natural gas in Japan. The USGS's incorporation of a net back approach into the Phillips formula and the Service's subsequent adoption of a net back formula based on certain actual costs represent a clear rejection of Marathon's argument. Although our examination

of the facts in the administrative record "is to be searching and careful," we are not "empowered to substitute [our] judgment for that of the agency," *id.*

Whether liquefied natural gas is different from natural gas is not before us and was not properly before the district court. Reviewing the informal agency decision in this case does not require us to consider whether there was substantial evidence in the record regarding the nature of liquefied natural gas. On the actual issue before us — the reasonableness of the Secretary's net back formula, *see id.*, Marathon has not pointed to any relevant factors that the Service failed to consider prior to issuing the order. Furthermore, we do not conclude that the Service clearly erred in adopting a net back valuation formula to determine royalties due on Marathon's sale of liquefied natural gas.

2.

Marathon also contends that a genuine issue of material fact exists as to whether the Service waived authority to administer one of the leases in the Kenai Field Unit conveyed to Cook Inlet by the government. Marathon relies on a letter the Service delivered to Union Oil Company and on an agency regulation, 43 C.F.R. § 2650.4-3 (1985), to contend that the Service has waived administration of the lease. The regulation provides that "administration shall be waived when the conveyance covers all the land embraced within a lease . . . unless there is a finding by the Secretary that the interest of the United States requires continuance of the administration by the United States." *Id.* There was no need for the district court to decide whether the waiver occurred because the issue was not properly preserved. Marathon failed to raise this issue during the public hearing or during the 30-day comment period or in its appeal from the initial order.

As a general rule, we will not consider issues not presented before an administrative proceeding at the appropriate time. *See Reid v. Engen*, 765 F.2d 1457, 1460 (9th Cir. 1985)

(*Reid*); *Inter-Tribal Council v. Department of Labor,* 701 F.2d 770, 771 (9th Cir. 1983) (per curiam). We have recognized, however, a number of exceptions to the general rule. "We may decide an issue not raised in an agency action if the agency lacked either the power or the jurisdiction to decide it." *Reid,* 765 F.2d at 1461; *see Reese Sales Co. v. Hardin,* 458 F.2d 183, 187 (9th Cir. 1972). This type of issue typically implicates the constitutionality of a statute or regulation where the agency does not have power to correct a claimed grievance. *Reid,* 765 F.2d at 1461; *see, e.g., Bagues-Valles v. INS,* 779 F.2d 483, 484 (9th Cir. 1985). Marathon's contention that the Service waived authority to administer one of the leases in the Kenai Field Unit does not involve a constitutional question, suggest that agency power or jurisdiction to decide the issue was lacking, or suggest that the Service was foreclosed from responding to its claim. Therefore, this exception to the rule of administrative exhaustion is inapplicable here.

Another exception permits us to "decide issues over which an agency has power and jurisdiction when 'exceptional circumstances' warrant such review, notwithstanding the petitioner's failure to present them to the agency." *Reid,* 765 F.2d at 1461; *see Page v. Donovan,* 727 F.2d 866, 868 (9th Cir. 1984); *Getty Oil Co. v. Andrus,* 607 F.2d 253, 255-56 (9th Cir. 1979). We have previously distinguished between administrative exhaustion requirements that are based on a statutory directive and those that are judicially imposed. *Reid,* 765 F.2d at 1462; *Montgomery v. Rumsfeld,* 572 F.2d 250, 252-53 (9th Cir. 1978) (*Montgomery*). Statutory exhaustion requirements implicate concerns of separation of powers and, therefore, the failure to comply with the requirements deprives us of jurisdiction. *Reid,* 765 F.2d at 1462; *Montgomery,* 572 F.2d at 252-53. We are unaware of any statutory exhaustion requirements that apply here. Thus, we may review Marathon's contention that the Service waived authority to administer one of the leases if exceptional circumstances exist.

In determining whether exceptional circumstances exist, we balance "the agency's interests 'in applying its expertise, correcting its own errors, making a proper record, enjoying appropriate independence of decision and maintaining an administrative process free from deliberate flouting, and the interests of private parties in finding adequate redress for their grievances.'" *Litton Industries, Inc. v. FTC,* 676 F.2d 364, 369-70 (9th Cir. 1982), *quoting Montgomery,* 572 F.2d at 253. Marathon presents us with no reasons why it did not raise the questions it had concerning the alleged waiver during the agency proceedings. Marathon's failure to raise the issue precluded the Service from interpreting its own regulation, particularly with respect to the timeliness, form, and other requirements of the Secretary's finding. *See Reid,* 765 F.2d at 1462. After balancing the relevant interests, we conclude that Marathon has waived this argument by failing to raise it at the agency level. Marathon has provided us with no evidence of exceptional circumstances that would warrant consideration of this contention. *See Duncanson-Harrelson Co. v. Director, Office of Workers' Compensation Programs,* 644 F.2d 827, 832 (9th Cir. 1981).

3.

Marathon also argues that there is a genuine issue of material fact concerning whether Cook Inlet improperly influenced the Service's decision to adopt the net back valuation formula. Marathon contends that private negotiations memorialized in a Memorandum of Understanding (MOU II) show that improper influence occurred. The district judge, however, concluded that since the order requiring compliance with the net back valuation formula was issued one month in advance of MOU II, Marathon's general allegations of impropriety failed to provide factual support for its theory of inappropriate and illegal negotiations. 604 F. Supp. at 1387-88; *see Burglin v. Morton,* 527 F.2d 486, 489 (9th Cir. 1975), *cert. denied,* 425 U.S. 973 (1976). We agree.

Consequently, no genuine issue of material fact remained to prevent the district judge from granting the government's motion for summary judgment. *See Kung v. FOM Investment Corp.*, 563 F.2d 1316, 1318 (9th Cir. 1977) (per curiam); *California v. Department of Transportation*, 561 F.2d 731, 733 n.4 (9th Cir. 1977).

AFFIRMED.

B. DISTRICT COURT ORDERS

1. District Court Order and Injunction Issued May 1, 1985.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA

MARATHON OIL COMPANY,	)	
Plaintiff,	)	
v.	)	No. A83-208 Civil
UNITED STATES OF AMERICA, *et al.*	)	
Defendants.	)	

ORDER

For the reasons stated in the opinion in this action issued and filed by the Court on February 20, 1985, including the findings of fact and conclusions of law set forth therein, IT IS HEREBY ORDERED that:

1. Federal Defendants' Motion for Summary Judgment and Partial Dismissal, filed in this Court on December 17, 1984, is granted, and the administrative orders issued to Marathon Oil Company by the Department of the Interior on July 8, 1983, October 5, 1983, and June 11, 1984 are upheld as valid.

2. Marathon Oil Company's claims against the Federal Defendants are dismissed.

3. Marathon Oil Company's Motion for Preliminary Injunction and Judicial Stay of Administrative Action, filed in this Court on November 5, 1984, is denied.

4. The Federal Defendants are entitled to an injunction, and accordingly Marathon Oil Company is re-

quired to calculate and pay royalties on the natural gas produced from its Kenai Unit leases, liquefied at its LNG facility in Nikiski, and sold in Japan, in accordance with the Department of the Interior letters dated January 6, 1983, February 28, July 8, 1983, October 5, 1983 and June 11, 1984. Copies of those letters are attached hereto as Exhibits A through E and made a part of this Order. The payment hereby required shall be made in the time and manner required by paragraph 5 below.

5(a). Marathon Oil Company is required to conduct an accounting to determine the amount of royalties due for the period between April 1, 1983 and July 31, 1983, based upon the "Phillips Formula" referred to in the letter order of October 5, 1983, and to conduct an accounting to determine the amount of royalties due since August 1, 1983, calculated under the methodology prescribed in the Department of the Interior letters dated January 6, 1983 and February 28, 1983, including interest thereon to the date of payment computed in accordance with the interest rate provisions of 30 U.S.C. § 1721(a). Such an accounting shall be filed with the Court and served on the parties no later than 45 days from the date of this Order. At the time of filing such accounting, Marathon shall make payment to the Federal Defendants of the additional royalty amounts and interest determined to be owing based upon the accounting.

(b). By that same date, Marathon shall make available to the Federal Defendants all supporting information and documentation used to prepare the accounting and such other relevant information as is necessary to review the accounting. Within 60 days of receipt of the above-required accounting, the Federal Defendants shall formally accept or object in writing to the accounting. If the Federal Defendants object to the accounting, Marathon is required, within 20 days of receipt of those objections to make any additional royalty and interest payments required by the accounting and any objections; Marathon

also shall begin to make its regular monthly payments as required by the accounting and any objections. At the time Marathon makes any such additional payment it shall file with the Court and serve upon the federal defendants a written response to the Federal Defendants' objections to the accounting. Within 20 days after receipt of Marathon's response and payment, Federal Defendants shall file with the Court and serve upon Marathon their final determination with respect to the accounting and royalty value.

6. Upon Marathon's submission of the accounting and payments required by paragraph 5, Marathon shall be deemed to have complied with this injunction.

7. Enforcement of the injunction granted herein shall be stayed for a period of ten days from the date of this Order to enable Marathon to apply to the Court of Appeals for a stay pending appeal.

8. In the event that objections to Marathon's accounting are filed by Federal Defendants, and Marathon disagrees with those objections and Federal Defendants' final determination, the Court will conduct further proceedings. The Court retains jurisdiction to conduct such proceedings, if necessary, to enter judgment in favor of the United States for the amounts ascertained to be owing by Marathon and to determine any remaining matters.

MADE AND ENTERED at Anchorage, Alaska, this 1st day of May, 1985.

/s/ JAMES M. FITZGERALD

James M. Fitzgerald
United States District Judge

APPROVED AS TO FORM:

RICHMOND & ASSOCIATES,
a Professional Corporation

/s/ DANIEL T. QUINN

Robert L. Richmond
Daniel T. Quinn

Attorneys for Plaintiff
and Counterdefendant
Marathon Oil Company

[The MMS Orders, attached to the District Court order as exhibits are omitted here but are reproduced at Appendix C.]

2. District Court Opinion and Order Issued February 20, 1985.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA

MARATHON OIL COMPANY, *Plaintiff,* v. UNITED STATES OF AMERICA; UNITED STATES DEPARTMENT OF THE INTERIOR; DONALD HODEL, Secretary of the Interior; ESTHER WUNNICKE, Commissioner of the Department of Natural Resources, State of Alaska; COOK INLET REGION, INC., an Alaska corporation, *Defendants.*	No. 85-3800 A83-208 Civil
COOK INLET REGION, INC., an Alaska Corporation, *Counterclaimant,* v. MARATHON OIL COMPANY, an Ohio corporation, *Counterdefendant.*	

JAMES M. FITZGERALD, Chief Judge.

Plaintiff Marathon Oil Company owns an undivided fifty percent working interest in certain oil and gas leases in the Kenai Field Unit in Alaska. Marathon and its working interest associate, Union Oil Company of California, discovered natural gas in the Kenai field in 1959, and production commenced in 1961.

During 1982, a representative year, the production of the Kenai field was delivered to a number of different purchasers. Approximately 16% was delivered to a liquefied natural gas (LNG) plant at Nikisi [sic], Alaska owned by Marathon and Phillips Petroleum Company. Over 42% of Kenai field gas was delivered to an ammonia and urea plant at Mikisi [sic] owned by Collier Chemical Company, a subsidiary of Union Oil Company. Over 31% of production was sold to Alaska Pipeline Company under a long-term contract for distribution in the Anchorage market. About 9% of the gas was rented to the Swanson River Field Unit for pressure maintenance. A small portion of the gas was sold under contract to the City of Kenai, and a portion was used in production operations in the Kenai field.

Each of the defendants, the United States, the State of Alaska, and Cook Inlet Region, Inc. (CIRI), is entitled to receive royalties on gas produced in the Kenai field. There are both federal leases and state leases in the Kenai field. The leases are of four types: (a) leases which were originally federal leases covering lands later conveyed to the state pursuant to the Statehood Act;[1] (b) leases which were originally federal leases covering lands later conveyed to CIRI pursuant to the Alaska Native Claims Settlement Act (ANCSA);[2] (c) federal leases covering lands currently held by the United States; and (d) state leases covering lands currently held by the state. All of the federal leases provide that Marathon shall pay 12½% royalty on the reasonable value of production from the leased lands. Alaska does not directly receive royalties from production attributable to the federal leases. However, under a provision of the Mineral Lands Leasing Act,[3] Alaska is entitled to 90% of all royalties received by the United States from oil and gas production on federal lands in the Kenai field.

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[1] Pub. L. No. 85-508, 72 Stat. 339 (1958).
[2] 43 U.S.C. §§ 1601-1628 (1982).
[3] 30 U.S.C. § 191 (1982).

A dispute arose in 1977 between Marathon and the United States Geological Survey (USGS)[4] as to the proper method of computing the reasonable value, for royalty purposes, of that part of gas production from federal leases delivered to the LNG plant. Gas delivered to the plant is cooled through a multi-step cooling process to transform it into a liquid. The liquefied natural gas (LNG) is then transported by tanker to Japan where it is sold to two utility companies. Marathon had been computing royalties on this gas on the basis of the price paid for Kenai field gas under the long-term contract with Alaska Pipeline Company. In 1977 USGS took the position that royalty value was to be established on the basis of the sales price for LNG in Japan less expenses.[5]

To resolve the dispute, Marathon and the USGS entered into an agreement on February 6, 1981, retroactive to January 1, 1980.[6] The settlement agreement provided that royalties were to be computed using the "Phillips formula" which had been developed for use by Phillips Petroleum Co. in computing royalties due the state of Alaska under state leases for gas delivered to the LNG plant at Nikisi [sic]. Under the Phillips formula, Marathon was to pay royalties based on 36% of the per MMbtu price received in Japan for the LNG (less certain adjustments). In addition, Marathon paid USGS $1,834,160.83 representing additional royalties due from January 1, 1980 through February 1981. The settlement agreement was, by its terms, effective "until such time as changes in market conditions, State or Federal law, or regulations adopted thereunder . . . necessitate a revision in the method used to determine the wellhead value."[7]

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[4] The responsibility for management of federal oil and gas leases is now held by the Minerals Management Service (MMS) of the Department of the Interior (DOI).

[5] Letter of Oct. 31, 1977 from Rodney A. Smith, USGS, to John R. South, Marathon Oil Co., Administrative Record (A.R.) 100.

[6] Letter of February 6, 1981 from James P. Murphy, Marathon Oil Co., to Barry A. Boudreau, USGS, A.R. 145.

[7] *Id.* at 3.

On January 6, 1983, the Minerals Management Service (MMS) notified Marathon of MMS's intention to redetermine the reasonable value for computing royalties on gas delivered to the LNG plant.[8] The letter stated that the basic net back valuation theory by which the reasonable wellhead value was derived from the sales price in Japan was sound, but that adjustments were necessary to reflect changing costs and prices due to economic conditions. MMS proposed to update the coefficients in the Phillips formula to reflect current processing and transportation costs.

The letter also informed Marathon that MMS would hold a public hearing on the matter in Anchorage, and that Marathon had thirty days to file written comments, evidence, and legal argument. Moreover, Marathon would have an opportunity at the hearing to present its views to MMS. A public hearing was held in Anchorage on March 1, 1983, and at that time Marathon appeared and offered information on its own behalf.[9]

Based on the hearing, written comments, and other materials, MMS on July 8, 1983 issued an order to Marathon directing the company to begin paying royalties as of August 1, 1983 based on the revised computations.[10] Marathon did not comply but filed an appeal of the July 8 order. In substance, Marathon disputed MMS's authority to redetermine the royalty basis, claiming that by notifying Marathon of the intended change in computation, MMS had repudiated the settlement agreement based on the Phillips formula. Moreover, effective April 1, 1983, Marathon unilaterally rolled back the basis on which royalties on gas delivered to the LNG plant were computed to presettlement rates. That is, rather than following

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[8] Letter of Jan. 6, 1983 from Robert E. Boldt, MMS, to Al Mechler, Jr., Marathon Oil Co., A.R. 47.

[9] *See* A.R. 39.

[10] Letter of July 8, 1983 from William H. Feldmiller, MMS, to Curtis Dowden, Marathon Oil Co., A.R. 8.

the formula of 36% of the price received in Japan, which had been in effect since January 1980, Marathon began to compute royalties based on the long-term contract price paid by Alaska Pipeline Company for Kenai field gas.

Under the July 8, 1983 order of MMS, Marathon was required for royalty purposes to compute the value for gas delivered to the LNG plant at $3.00/Mcf. By the terms of the settlement agreement based on sales of LNG in Japan, Marathon in the period immediately prior to April 1, 1983 computed the value of gas for royalty purposes at $1.71/Mcf. After that date, Marathon computed the value of gas at $.61/Mcf based on the contract price for Kenai field gas paid by Alaska Pipeline Company.

After MMS learned Marathon had unilaterally rolled back the price effective April 1, 1983, the agency issued a second order, dated October 5, 1983, directing Marathon to compute the value of gas for royalty purposes under the settlement or Phillips' formula for the months of April through July 1983.[11] Once again, Marathon did not comply with the MMS order. Finally, on June 11, 1984, the Department of the Interior (DOI) issued a third order directing Marathon to comply with the previous orders of MMS.[12]

Marathon filed a complaint in this court on April 14, 1983 challenging the revised valuation method proposed by MMS. The original complaint has been amended to challenge the three DOI orders issued after the complaint was filed.[13] In its

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[11] Letter of Oct. 5, 1983 from Milton K. Dial, MMS, to D.J. Durham, Union Oil Co. (as agent for Marathon Oil Co.), A.R. 9.

[12] Letter of June 11, 1984 from Assistant Secretary for Land and Minerals Management, Department of the Interior, to William F. Swales, Marathon Oil Co., and Ray A. Burke, Union Oil of California, A.R. 11.

[13] Marathon amended its complaint on October 7, 1983, and again on September 4, 1984.

amended complaint, Marathon now seeks declaratory relief to resolve the actual controversy among the parties involving the proper method of determining the wellhead value of the natural gas for royalty purposes. Apart from that, Marathon seeks redress for breach of lease provisions, for an accounting, for restitution, and to secure Marathon's rights under the United States Constitution and the Alaska Constitution.

The federal government in answer to the amended complaint denies that Marathon is entitled to relief for any of its claims and seeks to have the claims dismissed. In a counterclaim, the federal government contends that effective August 1, 1983, Marathon was required to compute royalties on production delivered to the LNG plant in accordance with the MMS orders. Under those orders, the reasonable value of gas at the wellhead is deemed to be $3.00/Mcf, as opposed to the $.61/Mcf value used by Marathon since April 1983. Moreover, the government requests that Marathon be required to pay $717,705 as unpaid royalties on production for the period from April through July 1983 computed using the Phillips formula. Since Marathon has persistently failed to comply with the applicable statutes, regulations, and terms of its leases, the government requests an order from this court cancelling the leases and requiring Marathon to account for all royalty payments due and for judgment in the proper amount.

On October 1, 1984, the federal government requested that a preliminary injunction issue in this case to compel Marathon to pay the royalties on production delivered to the LNG plant in accordance with the MMS orders. A conference was held on December 3, 1984 to expedite the case and a schedule was agreed to for the filing of motions addressing the merits. The federal government filed for summary judgment on December 17, 1984. The ruling on the government's application for a preliminary injunction was deferred until the motion for summary judgment was heard. I now grant summary judgment and direct that Marathon comply with the MMS orders.

THE CLAIMS

Marathon's amended complaint includes claims of contract impairment amounting to constitutional deprivation. Marathon argues that in the MMS letters of January 6, 1983 and February 28, 1983, the federal defendants gave clear indication of intention to breach and repudiate the terms of the settlement agreement and provisions within the federal leases. By so doing, Marathon claims, the federal defendants violated Marathon's constitutional rights, suggesting that only in federal court could Marathon obtain vindication of its constitutional rights. Alternatively, Marathon contended that the Administrative Procedure Act provided for immediate judicial review of the MMS orders.[14]

So far as Marathon's contract and constitutional claims are concerned, I conclude they are entirely without merit. Under the statutes and regulations providing for the administration of federal oil lease [sic], MMS has the authority and the responsibility to determine the reasonable value of gas production for the purpose of computing royalties. The settlement agreement of February 6, 1981 can in no way restrict the proper exercise of the agencies' statutory authority. Moreover, I conclude no constitutional impairment of contract or other constitutional deprivation is involved in this litigation.

Apart from Marathon's constitutional claims, I do conclude that Marathon is entitled to judicial review of the MMS orders pursuant to § 704 of the Administrative Procedure Act without awaiting further administrative proceedings. The federal defendants at an earlier stage of this proceeding had urged that judicial review was now inappropriate because Marathon had failed to exhaust administrative remedies. The federal defendants have since withdrawn the claim of lack of administrative finality and have agreed that judicial review of the administrative proceedings is now appropriate, and I so hold.

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[14] 5 U.S.C. § 704 (1982).

SCOPE OF REVIEW

Since the federal defendants have moved for summary judgment in this case, the test is whether, with respect to any dispositive issue, there is any genuine issue as to any material fact.[15] If not, I must decide whether, construing the evidence in the light most favorable to the plaintiff Marathon, the defendants are entitled to judgment as a matter of law.

Section 706 of the Administrative Procedure Act (APA) establishes the appropriate standard of judicial review of agency decision. Under that provision, the agency's determination must be set aside if found to be arbitrary or capricious, or in violation of constitutional, statutory, or procedural requirements.[16]

Given my earlier rejection of Marathon's constitutional claims, I must now make a three-part determination.[17] First, did the agency act within the scope of its statutory authority? In making this inquiry, I need only determine whether the agency was in substantial compliance with the applicable statute(s).[18] Second, was the agency decision "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"?[19] As the Supreme Court has observed:

> To make this finding the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear

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[15] Fruehauf Corp. v. Royal Exchange Assurance of America, Inc., 704 F.2d 1168, 1171 (9th Cir. 1983).

[16] 5 U.S.C. § 706(2)(A)-(D). Subsections (2)(E) and (2)(F) of § 706 apply only under a limited set of circumstances not relevant here. *See* Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 414-15 (1971).

[17] *Overton Park*, 401 U.S. at 415-17; Arizona Past and Future Foundation, Inc. v. Lewis, 722 F.2d 1423, 1425 (9th Cir. 1983).

[18] MarkAir, Inc. v. Civil Aeronautics Board, 744 F.2d 1383, 1385 (9th Cir. 1984).

[19] 5 U.S.C. § 706(2)(A).

> error of judgment. Although this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency.[20]

Third, did the agency comply with all procedural requirements?[21]

In reviewing an agency decision, the agency's own interpretation of the applicable statutes is entitled to substantial deference.[22] Deference is even more clearly in order where an administrative regulation, rather than a statute is involved.[23] According to the Supreme Court, "the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation."[24]

To uphold the MMS orders, I need not find that the MMS's interpretation of the statutes and regulations is the only reasonable interpretation, nor that it is the interpretation a court would reach if initially faced with the question. I need only find that it is a reasonable interpretation.[25] I must ascertain whether

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20 *Overton Park,* 401 U.S. at 416 (citations omitted).

21 In this case, Marathon does not challenge the MMS orders on the basis of procedural error.

22 Chevron, U.S.A., Inc. v. NRDC, __ U.S. __, 104 S. Ct. 2778, 2782-83 (1984); Blum v. Bacon, 457 U.S. 132, 141-42 (1982); MarkAir, Inc. v. Civil Aeronautics Board, 744 F.2d 1383, 1385 (9th Cir. 1984); Olivares v. Immigration and Naturalization Service, 685 F.2d 1174, 1177 (9th Cir. 1982).

23 Udall v. Tallman, 380 U.S. 1, 16-17 (1965).

24 Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414 (1945); *see also* Hoover & Bracken Energies, Inc. v. United States Department of the Interior, 723 F.2d 1488, 1489 (10th Cir. 1983) (according considerable deference to Department of Interior's interpretation of what is now 30 C.F.R. § 206.103), *cert. denied,* __ U.S. __, 105 S. Ct. 93 (1984).

25 American Paper Institute, Inc. v. American Electric Power Service Corp., 461 U.S. 402, 422-23 (1983).

MMS "articulate[d] a rational connection between the facts found and the choice made."[26]

DISCUSSION

Although Marathon has articulated a wide variety of claims and arguments in this case, the focus of the dispute centers upon whether MMS has the authority to use the net back theory of valuation for computing royalties on the gas delivered to the Nikisi [sic] LNG plant.

The Mineral Lands Leasing Act,[27] enacted in 1920 and amended since, governs federal oil and gas leases. The Act was intended "to promote wise development of natural resources and to obtain for the public reasonable financial returns on assets belonging to the public."[28] The gas leases at issue in this case were granted under the authority of the Mineral Lands Leasing Act and by their terms are "subject to the terms and provisions of" the Act.[29]

Between 1976 and 1981, the General Accounting Office (GAO) issued several reports documenting problems in federal oil and gas royalty management and collection.[30] The October 1981 report identified the shortcomings:

> Historically, the Geological Survey has not placed a high priority on collecting oil and gas royalties.

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[26] Bowman Transportation, Inc. v. Arkansas-Best Freight Systems, Inc., 419 U.S. 281, 285 (1974); Kunaknana v. Clark, 742 F.2d 1145, 1151 (9th Cir. 1984).

[27] 30 U.S.C. §§ 181-287 (1982).

[28] Mountain States Legal Foundation v. Andrus, 499 F. Supp. 383, 392 (D. Wyo. 1980).

[29] *See* leases reprinted in A.R. 14.

[30] *See* GAO, Oil and Gas Royalty Collections — Longstanding Problems Costing Millions (Oct. 29, 1981), A.R. 56; GAO, Oil and Gas Royalty Collections — Serious Financial Management Problems Need Congressional Attention (April 13, 1979), A.R. 57; GAO Indian Natural Resources — Part II: Coal, Oil and Gas, Better Management Can Improve Development and Increase Indian Income and Employment (Mar. 31, 1976), A.R. 58.

> Because sufficient management attention has not been focused on correcting deficiencies previously reported, financial management problems existing 20 years ago persist today. As a result, the Geological Survey is not collecting all oil and gas royalties; hundreds of millions of dollars owed the Government may be going uncollected each year. Moreover, millions of dollars in royalty income are not collected when due, thus increasing the Government's interest costs.[31]

In July 1981, the Secretary of the Interior established the Commission on Fiscal Accountability of the Nation's Energy Resources (known as the Linowes Commission) to investigate the problems. The Commission issued its lengthy report in January 1982, detailing 60 recommendations for revising the system.[32] The report summarized:

> Management of royalties for the Nation's energy resources has been a failure for more than 20 years. Because the Federal government has not adequately managed this multibillion dollar enterprise, the oil and gas industry is not paying all the royalties it rightly owes. The government's royalty record-keeping for Federal and Indian oil and gas leases is in disarray. For this reason, the exact amount of underpayment is unknown. The results of individual audits, which have often uncovered large underpayments, suggest that hundreds of millions of dollars due the U.S. Treasury, the States, and Indian tribes are going uncollected every year.
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> * * * *
>
> The Nation can no longer afford mismanagement of royalties for its energy resources. The stakes are too high. With the rapid escalation of energy prices, oil and gas royalties have risen from less than $500 million in 1971 to more than $4 billion in 1981.
>
> The government's royalty management system needs a thorough overhaul.[33]

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[31] A.R. 56 at 1.

[32] A.R. 55.

[33] *Id.* at xv.

Both the Secretary of the Interior and Congress responded to the Linowes Commission report. The Secretary reorganized the royalty management and collection functions of the Department under the newly-created Minerals Management Service, and revised the fiscal and production accounting system.

Congress, on December 21, 1982, enacted the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA).[34] The express purpose of FOGRMA included:

> (1) to clarify, reaffirm, expand, and define the responsibilities and obligations of lessees, operators, and other persons involved in transportation or sale of oil and gas from the Federal and Indian lands and the Outer Continental Shelf;
>
> (2) to clarify, reaffirm, expand, and define the authorities and responsibilities of the Secretary of the Interior to implement and maintain a royalty management system for oil and gas leases on Federal lands, Indian lands, and the Outer Continental Shelf;
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> (3) to require the development of enforcement practices that ensure the prompt and proper collection and disbursement of oil and gas revenues owed to the United States and Indian lessors and those inuring to the benefit of States;[35]

The legislative history of FOGRMA provides additional evidence that the law was intended to ensure that oil and gas royalties were accurately and promptly assessed and collected.[36] In FOGRMA, Congress mandated that the Secretary audit oil and gas lease accounts and make additional collections as warranted.[37] Furthermore, the statute states that "[t]he

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[34] 30 U.S.C. §§ 1701-1757 (1982).

[35] *Id.* § 1701(b).

[36] *See* H.R. Rep. No. 859, 97th Cong., 2d Sess., *reprinted in* 1982 U.S. Code Cong. & Ad. News 4268-4300; *see also* legislative history materials reprinted in A.R. 54.

[37] 30 U.S.C. § 1711(c)(1).

Secretary shall give priority to auditing those lease accounts identified by a State or Indian tribe as having significant potential for underpayment."[38]

Under the Minerals Lands Leasing Act, "[t]he Secretary of the Interior is authorized to prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes of [the Act]."[39] These regulations have the force and effect of statutes when not in conflict with such statutes.[40] The leases at issue in this case, in addition to being subject to the terms of the Mineral Lands Leasing Act, are also "subject . . . to all reasonable regulations of the Secretary of the Interior now or hereafter in force" unless inconsistent with the leases themselves.[41]

Administrative regulations governing MMS are found in 30 C.F.R. ch. II (1984). The particular regulation at issue in this case is 30 C.F.R. § 206.103, which provides:

> § 206.103 Value basis for computing royalties.
>
> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined

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38 *Id.*

39 30 U.S.C. § 189.

40 California Co. v. Seaton, 187 F. Supp. 445, 449 (D. D.C. 1960), *aff'd sub nom.* California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961).

41 *See* leases reprinted in A.R. 14.

> by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price per barrel, thousand cubic feet, or gallon paid or offered at the time of production in a fair and open market for the major portion of like-quality oil, gas, or other products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value.

Under this regulation, royalties are to be based on "the estimated reasonable value of the product as determined by the Associate Director [for Royalty Management]" with the proviso that "[u]nder no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof."

The regulation enumerates several factors to be considered in determining reasonable value, but does not mandate that any particular formula be used to compute reasonable value. In fact, the Associate Director is expressly directed to consider, in addition to the enumerated factors, "other relevant matters." The thrust of the regulation is that the value for royalty computation purposes set by the Associate Director must be reasonable. The only specific requirement in the regulation is that this value be no less than "gross proceeds." Thus this regulation vests considerable discretion in the Associate Director to decide what the "reasonable value" for royalty purposes shall be.[42]

The federal gas leases at issue in this case are by their own terms "subject to the terms and provisions of [the Mineral Lands Leasing Act] and to all reasonable regulations of the Secretary of the Interior now or hereafter in force, when not inconsistent with any express and specific provisions herein."[43]

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[42] *See* Continental Oil Co. v. United States, 184 F.2d 802, 821 (9th Cir. 1950).

[43] *See, e.g.*, Lease No. 028056 at 1, attached as Exhibit A to Marathon's Amended Complaint (filed Sept. 4, 1984).

The leases also provide that the lessee shall pay the lessor "12½ percent royalty on the production removed or sold from the leased lands computed in accordance with the Oil and Gas Operating Regulations."[44] The leases further state:

> It is expressly agreed that the Secretary of the Interior may establish reasonable minimum values for purposes of computing royalty on any or all oil, gas, natural gasoline, and other products obtained from gas, due consideration being given to the highest price paid for a part of for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters and, whenever appropriate, after notice and opportunity to be heard.[45]

Both the regulations and the leases, as discussed above, vest in the administrative agency the authority to establish the basis for computing royalties. The regulations require that the basis for royalty purposes "shall be the estimated reasonable value of the product as determined by the Associate Director." The leases expressly provide that "the Secretary of the Interior may establish reasonable minimum values for purposes of computing royalty."

As a preliminary matter, Marathon suggests that MMS by reason of prior agency action may well have been estopped from making the July 8 and October 5 orders. In support of this position, Marathon relies upon the February 6, 1981 settlement agreement and the September 10, 1979 "Duletsky Memo."

As to the settlement agreement,[46] it was by its terms effective "until such time as change in market conditions, State and Federal law, or regulations adopted thereunder . . . necessitate a revision in the method used to determine the well-

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[44] *Id.* at 2.

[45] *Id.*

[46] Letter of Feb. 6, 1981 from James P. Murphy, Marathon Oil Co., to Barry A. Boudreau, USGS, A.R. 145.

head value."[47] By January 1983, MMS determined that such changes in market conditions had occurred. In December 1982, Marathon executed a new contract with Alaska Pipeline Company (APL to sell its gas from the Kenai Unit and other nearby units at a base price of $2.32/Mcf. This price is in contrast to the $2.0149/Mcf Phillips formula price, and the $.586/Mcf price under the 1975 APL contract.[48] The higher prices being paid for Kenai gas under the new sales contracts were an indication to MMS that the settlement agreement no longer reflected the true value of the gas delivered to the LNG plant. I conclude that the terms of the provision in the settlement agreement expressly provided for revision in the event of a change in market conditions. Therefore, the February 6, 1981 settlement agreement in no way precluded MMS from later proposing a revised method of valuation.

Turning to the "Duletsky Memo,"[49] I likewise conclude that this document did not bind the federal defendants to a fixed and unalterable position. This memorandum constituted the response of John Duletsky, Acting Chief, Conservation Division of USGS, to an internal inquiry about how to value Kenai gas for royalty purposes. Duletsky discussed the applicability of a net back method of valuation to satisfy the requirement that the value be not less than gross proceeds, and

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[47] *Id.* at 3.

[48] *See* Federal Defendants' Memorandum of Points and Authorities in Support of Motion for Summary Judgment and Dismissal at 21-24 (filed Dec. 17, 1984) [hereinafter cited as Federal Defendants' Memorandum in Support]. Although Marathon refers to this discussion of contract prices as "*post hoc* rationalization," Marathon does not allege that the facts cited by MMS are incorrect. *See* Memorandum of Marathon in Opposition to Motion of Federal Defendants for Summary Judgment and Partial Dismissal at 54-55 (filed Jan. 2, 1985) [hereinafter cited as Memorandum of Marathon in Opposition].

[49] Memorandum of Sept. 10, 1979 from John Duletsky, Acting Chief, Conservation Division, USGS, to Oil and Gas Supervisor, Anchorage, Alaska, A.R. 124.

then concluded: "The term 'gross proceeds' . . . in our opinion, would be impractical to administer with respect to the Marathon [LNG] situation."[50]

I interpret Duletsky's position to be precisely as stated — that the use of the net back method was determined to be "impractical" when he authored the memorandum of September 10, 1979. Duletsky did not maintain that the gross proceeds regulation was not applicable to the LNG, nor could he rule out the possibility that the situation might change. In his memorandum Duletsky specifically noted that the agency "should also seek to establish a rational relationship between the landed value of the LNG in Japan and the value at the unit for royalty computation purposes so that the value for royalty purposes may be adjusted whenever there is an increase in the landed price."[51] In this statement, Duletsky acknowledged the relevance of the sales price in Japan to determination of value for royalty purposes. In fact, the settlement agreement of February 1981 established a basis for computing value for royalty purposes based on percentage of price paid in Japan for LNG.

I cannot agree with Marathon's contention that the Duletsky memorandum constituted an "express finding that the [gross proceeds] clause has no application to Marathon's LNG gas."[52] Given MMS's ongoing responsibility to ensure collection of all royalties due, I conclude the Duletsky memorandum represented nothing more than the position adopted at that time limited to the precise circumstances then existing.

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[50] *Id.* at 2.

[51] *Id.* at 4.

[52] *See* Marathon's Supplemental Memorandum in Opposition to the Federal Defendants' Motion for Summary Judgment and Partial Dismissal at 14 (filed Jan. 16, 1985) [hereinafter cited as Marathon's Supplemental Memorandum in Opposition].

The doctrine of equitable estoppel is applied to the government only under unusual circumstances.[53] Courts are especially reluctant to estop the government in cases involving rights to public lands.[54] Estoppel will be applied only "if the government's wrongful conduct threatens to work a serious injustice and if the public's interest would not be unduly damaged."[55] In this case, Marathon has not alleged any "serious injustice" resulting from MMS's decision to use the net back method to comply with the gross proceeds requirement in the regulation. Furthermore, the public treasury would suffer if these royalties due from gas leases on federal lands were not collected as due. I conclude that neither the 1981 settlement agreement nor the 1979 Duletsky memorandum preclude the agency from making its July and October orders. The question then becomes whether the valuation method adopted by MMS satisfies statutory and regulatory requirements and whether it is consistent with the leases.

The regulation[56] requires that the value of production for royalty purposes be not less than "the gross proceeds accruing to the lessee from the sale thereof." The phrase "gross proceeds" is not defined in the regulations. Marathon claims that the gross proceeds provision operates only to require that the value for royalty purposes include any additional sums, such as tax reimbursements, received by the lessee from the purchaser of the gas.[57]

I do not agree that the phrase should be so narrowly interpreted. One treatise defines "proceeds" as "the money

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53 Union Oil Co. v. Morton, 512 F.2d 743, 748 n.2 (9th Cir. 1975).

54 *Id.*

55 *Id.* (quoting United States v. Lazy FC Ranch, 481 F.2d 985, 989 (9th Cir. 1973)).

56 30 C.F.R. § 206.103 (1984).

57 Marathon's Supplemental Memorandum in Opposition, *supra* note 52, at 8-9.

obtained by an actual sale."[58] Marathon differentiates between "proceeds" type royalty clauses and "wellhead value" royalty clauses.[59] According to Marathon, the clause at issue here is a "wellhead value" royalty clause, and therefore the royalty value must be based on actual sales price in the field. I agree that the first sentence of the regulation directs the Associate Director to look to sales price in the field. However, the regulation does not end there. In the second sentence, it requires that the royalty basis be not less than the gross proceeds accruing to the lessee. Thus this regulation combines characteristics of a "wellhead value" royalty clause with characteristics of a "proceeds" type royalty clause. By its own language, the provision aims to ensure that the gross proceeds accruing to the lessee is the absolute minimum value for computation of royalties. In describing a "proceeds" type royalty clause, Professor Hemingway states: "Royalty payable upon the 'proceeds' of the sale of gas will be computed on the basis of aggregate gross receipts from all products less the costs of marketing and transportation."[60]

The gas Marathon delivers to the LNG plant is neither sold at the wellhead, nor at the LNG plant. Thus there is no simple way for MMS to value this production. The first arm's-length transaction involving this gas is the sale of the LNG in Japan. Recent changes in economic conditions suggested to MMS that neither the contract price for gas sold to Alaska Pipeline Co., nor the Phillips formula set out in the 1981 settlement agreement, represented a "reasonable value" for royalty computation purposes. MMS gave "due consideration" to the various factors and information before it in arriving at its

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[58] 8 H. Williams & C. Meyers, *Oil & Gas Law: Manual of Oil & Gas Terms* 572 (1982).

[59] Memorandum of Marathon in Opposition, *supra* note 48, at 17-19.

[60] R. Hemingway, *The Law of Oil and Gas* § 7.4, at 351 (2d ed. 1983).

decision.[61] To capture the true value of the LNG being sold in Japan, MMS determined it was necessary to look at the landed price in Japan and work back to arrive at a reasonable wellhead value. To do this, MMS proposed to make allowances for costs of liquefaction and transportation, and for a reasonable rate of return on the LNG plant. Deducting these allowances from the sales price in Japan would thus yield an estimated wellhead value for the gas.

Is there "good reason" supporting MMS's decision to look to the sales price in Japan, rather than to open market contracts for the sale of other gas from the Kenai field? Again, I conclude yes. The regulation provides:

> In the absence of good reason to the contrary, value computed on the basis of the highest price per . . . thousand cubic feet . . . paid or offered at the time of production in a fair and open market for the major portion of like-quality . . . gas . . . produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value.

Marathon contends that this provision should be followed to arrive at a reasonable value of gas delivered to the LNG plant for royalty purposes.[62] I conclude, however, that there exists "good reason to the contrary" warranting use of another method.

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[61] *See* Transcript of Deposition of Robert E. Boldt, Dec. 13, 1984 [hereinafter cited as Boldt Deposition].

[62] *See* Memorandum of Marathon in Opposition, *supra* note 48, at 22-24.

By its terms, the provision refers to "the price . . . paid or offered at the time of production in a fair and open market for the major portion of like quality . . . gas . . . produced and sold from the field or area." This assumes that reasonable value can be ascertained based on arm's-length transactions negotiated by unrelated parties each acting in their own self interest in competition with others.

It is obvious that market value of gas in any field will vary depending upon a wide variety of factors. So far as the Kenai field is concerned, 42% of the gas produced in 1982 was delivered to the ammonia and urea plant at Nikiski owned by Collier Chemical, a subsidiary of Union Oil. An additional 16% of production was delivered to the LNG plant owned by Marathon and Phillips. Alaska Pipeline Company bought 31% of production for distribution in the Anchorage market and 9% of production was rented to the Swanson River Field Unit for pressure maintenance. The gas delivered to the LNG plant presents a special, unique situation. At the plant the gas is cooled until it becomes liquid, then transported to Japan, and there sold. To capture the true value of this gas, it is reasonable for MMS to look to the proceeds accruing to Marathon in Japan.

The regulation requires that "Under no circumstances shall the value of production . . . for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale . . . or less than the value computed on such reasonable unit value as shall have been determined by the Secretary." Did MMS satisfy the explicit requirement that the value for royalty purposes be not less than the "gross proceeds" accruing to Marathon from the sale of the gas? I conclude the answer is yes. In fact, MMS determined that the net back method was necessary to satisfy the gross proceeds requirement. I agree with this determination.

Obviously the February 1981 settlement agreement demonstrates that the price paid for gas by Alaska Pipeline on its

long-term contract failed to provide reasonable value for purposes of computing royalty on that portion of the gas delivered to the LNG plant for sale in Japan. Even under the so called Phillips formula of 36% of the price received in Japan, the additional royalties from January 1, 1980 through February 1981 were computed to be $1,834,160.00. Thus Marathon's argument that "the 'gross proceeds' received by the lessee from the sale of [the LNG] with its enhanced values in a distant market are not indicative of the value of the raw material feedstock gas produced at the lease"[63] has a hollow ring. Since January 1, 1980, the effective date of the settlement agreement, Marathon paid royalties based on a "value" derived from the sales price in Japan. Marathon expressly agreed to this method in the February 1981 settlement agreement. Marathon cannot now credibly argue that landed sales price in Japan is irrelevant to the reasonable value for purposes of computing royalties.

Is MMS's net back method consistent with the regulatory language directing the agency to determine the *"value of production"* for royalty purposes? Marathon argues that this language requires that royalties be based on the value of production *at the lease.*[64] I agree with this basic premise. However, nothing in the regulation precludes MMS from looking at the sales price in Japan as a means to determine the reasonable value of production at the lease. MMS has done just this by taking the landed sales price, making allowances for liquefaction and transportation costs, and thereby deriving a reasonable value at the lease. The regulation does not preclude such computations, but rather requires them to ensure that the value chosen is not less than the gross proceeds accruing to the lessee. Thus I conclude that in deriving a value for royalty

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[63] Marathon's Supplemental Memorandum in Opposition, *supra* note 52 at 9.

[64] *See id.* at 7-8.

purposes from the sales price in Japan, MMS complied with the regulatory requirement that royalties be based on the "value of production."

MMS is charged with managing these national resources and ensuring that full royalties are levied and collected. Deriving an estimated wellhead value from the sales price of the LNG in Japan is, I conclude, a reasonable method of establishing a basis for computing royalties.

Furthermore, contrary to Marathon's assertions, the MMS orders do not represent a "stark departure" from previous agency positions.[65] As early as October 1977, the government took the position that to satisfy the gross proceeds provision, value for royalty purposes should be derived from the sales price in Japan.[66]

Does the regulation permit MMS to look to the sales price of LNG, a liquified substance, in determining the value for royalty purposes of the natural gas at the lease? I conclude it does. Marathon contends that the LNG sold in Japan is a manufactured product quite distinct from the natural gas at the wellhead.[67] I am not persuaded. LNG is natural gas that has been cooled for purposes of storage or shipment.[68] There is no alteration of the chemical properties of the gas. Regardless of whether liquefaction is termed "processing" or "manufacturing," the fact remains that the LNG delivered in Japan is chemically identical to the natural gas at the lease. Therefore MMS did not violate the regulation when it directed that the royalty basis for the gas be derived from the sales price of the LNG in Japan.

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[65] *See* Memorandum of Marathon in Opposition, *supra* note 48, at 7-8.

[66] *See* Letter of Oct. 31, 1977 from Rodney A. Smith, USGS, to John R. South, Marathon Oil Co., A.R. 100.

[67] *See* Memorandum of Marathon in Opposition, *supra* note 48, at 37-41.

[68] *See* 8 H. Williams & C. Meyers, *Oil & Gas Law: Manual of Oil & Gas Terms* 405 (1982).

For these reasons, I conclude that the MMS orders directing Marathon to use the net back method fall within the agency's authority under the statutes and regulations. I also conclude that the orders neither violated nor were inconsistent with provisions of the leases. The leases by their express terms provide for a royalty to be paid "on the production removed or sold from the leased lands computed in accordance with the Oil and Gas Operating Regulations."[69] Marathon argues that like the regulatory language, this lease language requires royalties to be computed on value of production *at the lease.*[70] However, I have concluded that the net back method is a valid means of estimating the value of production for royalty purposes. Moreover, the leases themselves provide that the Secretary of the Interior has the authority to establish reasonable values for computation of royalties. I conclude that the MMS orders did not violate the terms of the leases.

In addition to challenging the substance of the MMS orders, Marathon also argues that the orders are invalid because MMS was unduly influenced by CIRI.[71] Marathon cites two Memoranda of Understanding (MOUs) between MMS and CIRI.[72] Marathon claims that by entering into the MOUs with CIRI, MMS violated a provision of ANCSA preserving existing rights of lessees of federal lands conveyed to

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69 *See* Lease No. 028056 at 2, attached as Exhibit A to Marathon's Amended Complaint (filed Sept. 4, 1984).

70 Marathon's Supplemental Memorandum in Opposition, *supra* note 52, at 4-7.

71 *See* Memorandum of Marathon in Opposition, *supra* note 48, at 24-31; Marathon's Supplemental Memorandum in Response to Reply Memorandum of Cook Inlet Region, Inc. at 2-11 (filed Jan. 23, 1985).

72 Memorandum of Understanding Between Minerals Management Service & Cook Inlet Region, Inc. (Jan. 3, 1983), A.R. 17 [hereinafter cited as MOU I]; Memorandum of Understanding II Between Minerals Management Service and Cook Inlet Region, Inc. (Aug. 9, 1983), A.R. 18 [hereinafter cited as MOU II].

native corporations,[73] and unlawfully delegated administrative authority and discretionary decisionmaking to CIRI, a private party.

MOU I was executed by Robert E. Boldt, Associate Director of Royalty Management for MMS, on January 3, 1983.[74] In the agreement, MMS made a partial waiver of administration of the leases to CIRI to enable CIRI to negotiate directly with Marathon and Union Oil Co., the lessees, to try to settle royalty and other disputes, and, if necessary, to bring suit in its own name.[75] MOU I also provides that CIRI may request that MMS audit the leases, and that MMS shall consult with CIRI regarding any lease matters which might affect CIRI's interests.[76]

I conclude that in executing MOU I, MMS did not unlawfully delegate its authority or otherwise violate Marathon's rights or interests. Paragraph 2 of the agreement lists areas of dispute between CIRI and the two lessees, Marathon and Union, primarily concerning royalties. The agreement itself states that "[this] partial waiver of administration is with regard to CIRI's negotiation of CIRI's interest in the Leases . . . with respect to the unresolved issues listed in paragraph 2(a)

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[73] ANCSA § 14(g), 43 U.S.C. § 1613(g) (1982).

[74] *See* MOU I, A.R. 17.

[75] *Id.* ¶¶ 2, 3.

[76] *Id.* ¶¶ 4, 6, 7. In addition, paragraph 5 of the agreement stated that the determinations in USGS letters dated October 1, 1979 and November 6, 1979 were withdrawn and rescinded insofar as they affected CIRI's interests. The administrative record contains several letters from USGS to Union Oil Company bearing these dates, *see* A.R. 126, 128, 129, but only one letter to Marathon. *See* Letter of Nov. 6, 1979 from Rodney A. Smith, USGS, to Marathon Oil Co., A.R. 127. As the federal defendants and CIRI point out, this November 6 letter was expressly rescinded by USGS one month later. *See* Letter of Dec. 11, 1979 from Rodney A. Smith, USGS, to Marathon Oil Co., A.R. 130. Marathon has not refuted this, and therefore has not explained how paragraph 5 of MOU I could have adversely affected its interests.

through (e). By this partial waiver CIRI is empowered to enter into negotiations and effect a settlement of those issues. . . ." ANCSA § 14(g) expressly authorizes the responsible agency to waive administration of leases on land conveyed pursuant to ANCSA, such as the land on which these leases are located.[77] The plain language of MOU I indicates that the purpose of the waiver was to enable CIRI to negotiate an out of court settlement of the royalty issues. MMS did not unlawfully transfer any decisionmaking authority to CIRI.

The provisions in MOU I providing that CIRI may request an audit, and that MMS shall consult with CIRI, likewise do not violate Marathon's rights. ANCSA provides that the native land settlement process should be accomplished "with maximum participation by Natives in decisions affecting their rights and property."[78] Thus MMS is not only entitled but in fact expressly directed to communicate with CIRI concerning the leases. Furthermore, any private party has the right to make its opinions known to the government and to advocate positions which would be to its benefit.

But there is additional evidence to support my conclusion that MOU I did not improperly influence MMS's decisionmaking process. In his sworn deposition testimony, Robert E. Boldt, MMS's Associate Director for Royalty Managment, state in response to several direct questions that MOU I did not influence or affect MMS's decision to issue the royalty orders at issue here.[79]

In MOU II, executed on August 9, 1983,[80] MMS adopted several "administrative standards" governing the leases.[81]

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77 43 U.S.C. § 1613(g) (1982).
78 *Id.* § 1601(b).
79 Boldt Deposition, *supra* note 61, at 42, 46, 69, 96, 98, 110.
80 A.R. 18.
81 *Id.* ¶¶ 3, 4.

Marathon argues that by adopting these standards, MMS unlawfully contractually committed itself to certain positions, thereby abdicating its responsibility for independent decisionmaking. However, the initial MMS order directing Marathon to use the net back method to compute royalties was issued on July 8, 1983, one month before MOU II was signed.[82] Thus MOU II could hardly have influenced MMS's decision to issue the July 8 royalty order. Furthermore, the July 8 order established the values to be used in the computation of royalties using the net back method. The decision to use that method had been made and so communicated to Marathon months earlier in the January 6, 1983 letter. The two subsequent MMS orders at issue in this case, dated October 5, 1983 and June 11, 1984, merely directed Marathon to comply with previous orders.[83] These subsequent orders were thus similarly not the result of any improper influence caused by MOU II.

I thus conclude that the MOUs between MMS and CIRI did not unlawfully influence the issuance of the MMS royalty orders. MMS neither contracted to take action beyond that already mandated by law, nor agreed to refrain from exercising its independent decisionmaking authority. The MMS net back royalty orders to Marathon are not invalidated by the MOUs.

Marathon raises several other complaints about the procedure by which MMS issued its orders. Marathon objects to the Administrative Record compiled and submitted by the federal defendants.[84] According to Marathon, there are documents in

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[82] *See* Letter of July 8, 1983 from William H. Feldmiller, MMS, to Curtis Dowden, Marathon Oil Co., A.R. 8.

[83] *See* Letter of October 5, 1983 from Milton K. Dial, MMS, to D.J. Durham, Union Oil Co. (as agent for Marathon Oil Co.), A.R. 9; Letter of June 11, 1984 from Assistant Secretary for Land and Minerals Management, Department of the Interior, to William E. Swales, Marathon Oil Co. and Ray A. Burke, Union Oil of California, A.R. 11.

[84] *See* Memorandum of Marathon in Opposition, *supra* note 48, at 32-37.

the record which should not be there, and certain documents are excluded with should be included. In particular, Marathon claims that "[m]uch of the so-called 'record' contains *post hoc* rationalizations,"[85] and points to documents created after the MMS royalty order(s) had been issued.

In a case such as this, the court is reviewing the agency's determination. There is no statutory requirement for formal rulemaking or adjudicatory proceedings. Therefore there is no formal agency record created to support the decision. Despite the absence of a formal record, it is the duty of the court to review the decision "based on the full administrative record that was before the [decisionmaker] at the time he made his decision."[86]

The federal defendants have compiled an admittedly voluminous administrative record in this case. As explained in their memorandum, "[t]he Department . . . accumulated all documents which it considered to have even the slightest relevance to the determination, seeking to avoid any controversy with regard to the record."[87] The response from Marathon was that the record was *too* voluminous.

I cannot agree with Marathon. I do not find deficiencies in the administrative record that would require an evidentiary hearing on the issue of the composition of the record. The omission Marathon complains of is that the appeal documents it filed with the agency were not included in the record. The federal defendants have since supplemented the record to include those documents.[88] As to Marathon's claim that docu-

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[85] *Id.* at 35.

[86] Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 420 (1971).

[87] Federal Defendants' Reply to Plaintiff's Opposition to Motion for Summary Judgment at 11 (filed Jan. 11, 1985) [hereinafter cited as Federal Defendants' Reply Memorandum].

[88] *See* Notice of Lodging Supplement to Administrative Record (filed Jan. 22, 1985).

ments were included which were created after the initial royalty order was issued, I find no prejudice to Marathon. According to the federal defendants, these documents were included because they support the subsequent orders and the Notice of Noncompliance issued to Marathon.[89] Such additions do not invalidate agency action unless substantial prejudice is shown to result.[90] Beyond the complaint that the record is too large, Marathon has not alleged that it suffered any substantial prejudice from the inclusion of these documents. Additional explanatory information is permitted to supplement the record.[91]

Marathon also claims that the MMS orders may have been improperly influenced by communications from congressional representatives.[92] However, Mr. Boldt, in his deposition, stated that any such communications occurred in April or May of 1984, almost a year after MMS issued its first royalty order.[93] Thus congressional communications could not have affected MMS's decision to issue the disputed royalty order.

In another claim, Marathon contends that by using different methods for valuing Marathon's gas delivered to the LNG plant and Union Oil Company's gas delivered to its ammonia/urea plant, MMS has violated Marathon's equal protection rights.[94] I do not agree. As discussed earlier, LNG is natural gas that has been cooled for shipment and storage

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89 *See* Federal Defendants' Reply Memorandum, *supra* note 87, at 12.

90 United States v. Pierce Auto Freight Lines, Inc., 327 U.S. 515, 530 (1946).

91 Kunaknana v. Clark, 742 F.2d 1145, 1149 (9th Cir. 1984); Asarco, Inc. v. United States Environmental Protection Agency, 616 F.2d 1153, 1158-60 (9th Cir. 1980).

92 *See* Memorandum of Marathon in Opposition, *supra* note 48, at 45.

93 *See* Boldt Deposition, *supra* note 61, at 116.

94 *See* Memorandum of Marathon in Opposition, *supra* note 48, at 48-51.

purposes. It is chemically identical to the gas produced at the well. At least in this connection, it differs from ammonia or urea which are quite different products from LNG. But in each case, MMS is required to follow the regulation and determine the reasonable value for royalty purposes, with gross proceeds as the required minimum. There is no requirement that the gas delivered to the LNG plant be valued by the same method as the gas delivered to the ammonia/urea plant so long as the agency complies with the regulation.

Marathon claims that MMS irrevocably waived administration of one of CIRI's leases in the Kenai unit, Lease A-028142.[95] In support, Marathon cites an August 1982 letter from MMS to Union Oil Co.[96] In this letter, MMS notified Union that the lands covered by part or all of three leases had been conveyed to CIRI pursuant to ANCSA. As to the two leases which had been only partially conveyed, MMS explicitly stated that administration would remain with MMS and that lease records were to be retained by MMS.[97]

As to the third lease, the letter stated:

> Lease A-028142 has been transferred in its entirety to the Cook Inlet Region Inc. . . . [ANCSA § 14(g) provides that the United States may waive administration of a lease containing lands which have been conveyed in their entirety.
>
> Pursuant to the above, your case file will be transfered . . . to: Cook Inlet Region, Inc. . . . Further correspondence concerning these leases should be made to [CIRI].[98]

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[95] Marathon's Supplemental Memorandum in Opposition, *supra* note 52, at 21-22.

[96] Letter of Aug. 25, 1982 from Jimmy W. Mayberry, MMS, to Wayne Hunt, Union Oil Co. of California, included in A.R. 15.

[97] *Id.* at 2.

[98] *Id.* at 3.

Although in the letter MMS stated that the United States "may" waive administration as to this lease, there is no language indicating that the United States has in fact waived administration. The applicable regulation provides that the agency may retain administration of a lease conveyed in its entirety if the agency finds it to be in the interest of the United States.[99] Marathon contends that no such finding has been made, but offers no evidence in support of this contention. The regulation does not require that such a finding be made in a formal written document. In oral argument, counsel for the federal defendants suggested that MMS has continued to administer this lease.[100]

The August 1982 letter provided that the lease had been transferred in its entirety, and that the case file would be transferred to CIRI. MMS did not state, however, that it was waiving administration. Because the terms used are prospective, I conclude that MMS has not waived administration as to this lease. Therefore, the MMS royalty orders are effective as to this lease.

CONCLUSION

For the reasons stated I upheld the orders issued by MMS to Marathon requiring computation of royalties using the net back method. Based on this holding, I GRANT the federal defendants' Motion for Summary Judgment and Partial Dismissal. Marathon's claims against the federal defendants are accordingly DISMISSED. I further find that the federal defendants are entitled to an injunction. Marathon is accordingly ORDERED to comply with the terms of the three MMS royalty orders. I DENY Marathon's Motion for a Preliminary Injunction and Judicial Stay of Administrative Action. I

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[99] 43 C.F.R. § 2650.4-3 (1983).

[100] Reporter's Transcript of Oral Argument on Motions at 83 (Jan. 4, 1985).

GRANT the federal defendants' prayer for an accounting to determine royalties due from Marathon. I retain jurisdiction to enter judgment for the United States when the amount has been ascertained, and to determine any remaining matters.

The federal defendants shall, within five days, serve and file a proposed Order consistent with this Opinion. Because I order Marathon to comply with the royalty orders, this decision is appealable as an injunction under 28 U.S.C. § 1292(a). Enforcement of this injunction is stayed for a period of ten days from the date the Order is signed and filed to enable Marathon to apply to the Court of Appeals for a stay pending appeal.

C. AGENCY ORDERS, INSTRUCTIONS AND NOTICE

1. Interior Department Assistant Secretary's Order Issued June 11, 1984.

[SEAL]

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

June 11, 1984

Mr. William E. Swales
Senior Vice President
Marathon Oil Company
539 Main Street
Findlay, Ohio 45840

Mr. Ray A. Burke
Senior Vice President, Energy Resources
Union Oil of California
461 S. Boylston Street
Los Angeles, California 90017

Gentlemen:

As you know, the Department of the Interior (Department) presently is involved in litigation with Marathon regarding the value used to compute royalties on gas produced and sold from certain Federal leases located in the Kenai Gas Field, Alaska (*Marathon Oil Company v. U.S.*, Civ. No. A83-208 Civ. (D. Alaska)). Related to this litigation are two orders issued by the Minerals Management Service (MMS) regarding royalties payable on these leases.

The first order was a letter dated July 8, 1983, from William Feldmiller, MMS, to Curtis Dowden, Marathon (Enclosure 1), which directed Marathon to begin calculating

royalties based on a net-back formula commencing with the royalty period August 1, 1983. According to our records, Marathon has not complied with this directive and has paid royalties since August 1 based upon a value considerably below that ordered by MMS.

The second order, dated October 5, 1983, from Milton K. Dial, Chief, Royalty Compliance Division, MMS, to Union Oil of California, paying agent for Marathon (Enclosure 2), directed Union to pay $717,705 in underpaid royalties for the period April 1983 to July 1983. According to our records, Union has not paid these royalties.

The obligation to pay royalties determined by MMS to be due and owing is not suspended by an administrative or judicial appeal of these orders. As a result, the Department is issuing this second order to Marathon, and to Union on behalf of Marathon, to pay the royalties due for the period April—July 1983 as prescribed in the letter of October 5, 1983, and to pay royalties in accordance with the July 8, 1983, letter for periods after July 31, 1983. This order is issued at the direction of the Secretary and, accordingly, constitutes a final decision by the Department pursuant to 43 C.F.R. Section 4.5(a).

If Marathon does not comply with both orders within 30 days from receipt of this letter, Marathon hereby is given notice that the Department will request the Attorney General of the United States to initiate proceedings in the United States District Court for the District of Alaska to cancel Marathon's interest in the Kenai leases. Lease cancellation for nonpayment of royalties is authorized by Marathon's leases (Section 7), Section 31 of the Mineral Lands Leasing Act of 1920, as amended, 30 U.S.C. Section 188, and by the applicable Departmental regulations (*see* 43 C.F.R. Section 1308.3(c)). In addition to initiating lease cancellation proceedings, the Department has available other enforcement measures.

It is still our hope that this situation can be resolved amicably between Marathon and the Government. We are available for further discussions if you desire.

Sincerely,

/s/ GARREY E. CARRUTHERS

Assistant Secretary for Land and Minerals Management

Enclosures

[Enclosures to this Order are omitted.]

2. Minerals Management Service Order Issued October 5, 1983.

[SEAL]

United States Department of the Interior

OFFICE OF THE SECRETARY
MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 5760
Denver, Colorado 80217-5760

MMS-RCD
MS 655

October 5, 1983

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. D.J. Durham
Union Oil Company of California
P.O. Box 7600
Los Angeles, California 90051

Dear Mr. Durham:

This office has conducted a review of the royalties paid by Union Oil Company (Union) on behalf of Marathon Oil Company (Marathon) for sales of natural gas produced from the Kenai Unit and delivered to the Liquified [sic] Natural Gas (LNG) plant at Nikiski, Alaska.

Under the terms of the applicable leases, the Department of the Interior is authorized to establish reasonable minimum values for purposes of computing royalty. Additionally, 30 C.F.R. 221.47 provides that "Under no circumstances shall the value of production . . . be deemed to be less than the gross

proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. . . ."

By Order dated January 4, 1980, the Secretary established a "value of no less than that paid to the State of Alaska for gas produced from the North Cook Inlet Field". Subsequently, by letter dated September 12, 1980, the minimum value was established based upon the so-called "Phillips Formula" (delivered LNG Contract price x 36 - $.0555 adjusted for quality as provided by NTL #5). By agreement dated February 17, 1981, Marathon agreed to abide by the terms of the "Phillips Formula" and to compute and pay royalties on that basis. On July 8, 1983, the Minerals Management Service (MMS), after concluding that the royalty paid pursuant to the "Phillips Formula" no longer met the regulatory criteria of 30 C.F.R. 221.47 due to changed market conditions, directed Marathon to calculate and pay royalty based upon a revised version of the "Phillips Formula" beginning with the payment due in August 1983. Marathon has refused to comply with the July 8, 1983, directive, and is pursuing an administrative appeal of the July 8, 1983, order.

As a result of a recent review, we have concluded that Union, as agent for Marathon, has paid royalty due the United States in periods prior to April 1983 using the "Phillips Formula." However, beginning April 1983 through July 1983, the last month of our review, Union, as agent for Marathon, has paid royalty using a value less than the minimum value directed by MMS or its predecessor agencies. Beginning in April 1983, Union, as agent for Marathon, has improperly, and contrary to MMS directives, used the value in the gas sales agreement with Alaska Gas Pipeline Company as the basis for royalty payments for the Kenai Unit. We have determined that, as a consequence, royalties for the months of April, May, June, and July have been underpaid by approximately $717,705. This amount was computed using the March 1983 unit price as

$1.817623, adjusted for Btu, times the reported production subject to royalty, less the amount previously paid by Union (see Attachments 1, 2, and 3).

Union, as agent for Marathon, is hereby directed to, within 30 days of receipt of this Order, recalculate the royalty due, consistent with the provisions of the "Phillips Formula" using the actual unit price for April, May, June, and July 1983, and submit payment of additional royalties so calculated. Furthermore, Union, as agent for Marathon, is hereby directed, until further notice to the contrary, to calculate and pay royalty due for periods after July 1983 consistent with the "Phillips Formula."

Attached is a "Bill for Collection" in the amount of $717,705 from the MMS Accounting Center in Lakewood, Colorado; your payment of this amount, or such amount as calculated to actual unit prices, should be sent to the address indicated on the Bill. A copy of all checks and Forms MMS-2014 (Report of Sales and Royalty Remittance) should be submitted to this office. Late payment penalties will be assessed at a later date consistent with applicable regulatory criteria.

Failure to respond to this assessment action within the allotted time period will result in alternative actions to secure your compliance. You have the right to appeal in accordance with the provisions of Title 30, Code of Federal Regulations, Part 290. Any appeal taken will be to the Director, MMS, and the notice of appeal must be filed with:

Mr. Milton K. Dial, Chief
Royalty Compliance Division
Minerals Management Service
Mail Stop 655
P.O. Box 25165
Lakewood, Colorado 80225
Telephone: (303) 231-3011

A copy of any appeal filed should be forwarded to:

Mr. Norman Bess
Chief Appeals Division
Minerals Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091
Telephone: (703) 860-7251

within 30 days from the date of this letter. The notice of appeal must be accompanied by a written showing, as you deem adequate, to justify reversal or modification of this directive. Within the same 30-day period, the appellant will be permitted to file additional statements of reason or written briefs. You may also request, pursuant to 30 C.F.R. 290.4, to present oral argument or evidence to the Director, MMS, and such motion should be filed with the Director who may, in his discretion, schedule a hearing at a time and place of his choosing. With the exception of the time fixed for filing a notice of appeal, the time for filing any documents in connection with an appeal may be extended by the Director, MMS. Any request for an extension of time must be filed within the 30-day period allowed for filing of the appeal document and must be filed with the same office in which the appeal document was filed.

If you have any questions concerning this matter, please call Mr. Erasmo Gonzales, Regional Manager, Houston Regional Compliance Office, at (713) 229-7783.

Sincerely,

/s/ MILTON K. DIAL

Milton K. Dial,
Chief Royalty Compliance Division

Enclosures

[Attachments to this Order are omitted]

3. Minerals Management Service Order Issued July 8, 1983.

[SEAL]

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225

MMS-RVS

July 8, 1983

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. Curtis Dowden
Anchorage Division, Production
Marathon Oil Company
Post Office Box 2380
Anchorage, Alaska 99510

Dear Mr. Dowden:

By a letter dated January 6, 1983, Marathon Oil Company (Marathon) was notified of the Minerals Management Service's (MMS) intent to determine the reasonable value for computing royalties on gas produced and sold from certain Federal leases located in the Kenai Gas Field. In that letter a "Proposed Methodology for Determining the Value for Royalty Purposes, of Natural Gas Produced on Federal and Indian leases in the Kenai Gas Field" was outlined and explained. The January 6, 1983, letter reaffirmed the soundness of the principles found in the net-back formula, but indicated that adjustments to the formula were necessary to reflect changes in economic conditions.

A subsequent letter dated February 28, 1983, which was sent at Marathon's request, provided additional detail on the proposed changes and worksheets instructing Marathon on the adjustments to be made to the manufacturing and transportation allowances. MMS directed Marathon to begin using actual processing and transportation costs to determine the then fixed coefficients found in the net-back formula. MMS concluded that such a change was warranted because of market changes within the Kenai area. A public hearing on the proposed change in the valuation formula was held on March 1, 1983, and written comments have been received. MMS has carefully reviewed the materials and comments submitted.

Having considered all the relevant materials bearing on the question of royalty computation for Kenai gas, including the price received by Marathon under its sales contract with Alaska Gas Pipeline Company for unprocessed gas, MMS concludes that the current net-back formula must be adjusted in the manner described and outlined in the January 6, 1983, and February 29, 1983 [sic], letters sent to Marathon. Therefore, Marathon is hereby directed to begin calculating royalties based on this adjusted formula for royalty valuation commencing with the royalty period August 1, 1983.

Marathon has the right to appeal this decision in accordance with the provision of Title 30, Code of Federal Regulations Part 290. Any appeal taken will be to the Director, Minerals Management Service, and notice of appeal must be filed with:

Mr. Norman Hess
Appeals Division
Minerals Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091

within 30 days from the date of receipt of this letter.

The notice of appeal must be accompanied by a written showing, as Marathon may deem adequate, to justify reversal or modification of this decision. Within the same 30-day period, the appellant will be permitted to file additional statements of reason or written briefs. Marathon may also request approval, pursuant to 30 C.F.R. 290.4, to present oral argument or evidence to the Director, Minerals Management Service, and such motion should be filed with the Director who may, in his discretion, schedule a hearing at a time and place of choosing.

With the exception of the time fixed for filing a notice of appeal, the time for filing any documents in connection with an appeal may be extended by the Director, Minerals Management Service. Any request for an extension of time must be filed within the 30-day period allowed for filing of the appeal document and must be filed with the same office in which the appeal document was filed.

Please be aware that regulations provide, and it is MMS policy, that the filing of an appeal will not suspend the requirement for compliance with this decision, 30 C.F.R. § 221.66 (1982).

Sincerely yours,

/s/ WILLIAM H. FELDMILLER

William H. Feldmiller
Chief, Royalty Valuation and Standards Division

4. Minerals Management Service Instructions Issued February 28, 1983.

[SEAL]

United States Department of the Interior

OFFICE OF THE SECRETARY
MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 5810
Denver, Colorado 80217-5810

MMS-PVB

February 28, 1983

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. Al Mechler, Jr., Manager
Anchorage Division Production
Marathon Oil Company
P.O. Box 2380
Anchorage, Alaska 99510

Dear Mr. Mechler:

Enclosed is the procedure to be used in valuing, for royalty purposes, the gas produced from the Alaska Kenai gas field. The gas produced by Marathon is liquefied and transported to Japan for sale.

The final unit value for royalty purposes will be expressed in the same manner as the method currently in use, the so-called "Phillips" formula ($V = AP - B$),

where: V is the value of the gas, for royalty purposes, on a per Mcf basis;

A is the proportion of the value per Mcf remaining after allowances are deducted for liquefaction of the gas and tankering it to Japan;

P is the delivered LNG contract price per Mcf in Japan or gross proceeds which accrue to Marathon, whichever is higher; and

B is the allowable transportation deduction per Mcf for the Kenai-Nikiski pipeline.

In determining an annual unit manufacturing and transportation allowance, Marathon is to apply the attached discounted cash flow procedure for recovering capital and amortized expenses associated with capital. Investment tax credit, depreciation, salvage and operating costs are taken into consideration. A reasonable return (profit), based on capital and amortized expenses will be allowed. Annual operating costs will be actual expenditures.

The enclosed worksheet will be updated annually and submitted to the Minerals Management Service (MMS). All backup materials shall be retained by Marathon to be made available for audit upon MMS request.

Marathon will compute the value, for royalty purposes, of the Kenai gas field gas as set forth in the enclosure and apply it prospectively for the upcoming 12-month period commencing with the July 1, 1983, royalty payment.

Copies of the worksheet are to reach MMS on or before the 1st day of July of each year. Marathon will pay royalties prospectively based on the revised worksheet calculation beginning the 1st day of July of each year.

Payments received will be considered accurate and correct, subject to possible audit within the six-year statute of limitations as established by the recent "Federal Oil and Gas Royalty Management Act of 1982."

We will be pleased to meet with you to discuss any questions you may have regarding this procedure.

/s/ WILLIAM H. FELDMILLER

William H. Feldmiller
Chief, Royalty Valuation and Standards Division

Enclosure

ENCLOSURE:

NET-BACK PROCEDURE TO BE USED IN VALUING, FOR ROYALTY PURPOSES, MARATHON'S ALASKA KENAI GAS FIELD PRODUCTION

General

Marathon's Kenai gas production is moved via pipeline to a processing plant, processed, and transported to the place of first sale in Japan. Storage facilities are required at the LNG plant. The value of the products at the point of sale is established by contract, but under no circumstances can the Minerals Management Service (MMS) accept less than gross proceeds as the basis for royalty valuation purposes.

By taking the contract value or gross proceeds and subtracting from it all costs and expenses incurred in processing, storing, and transporting the products between the point of sale and the lease, the value of the products at the lease boundary can be obtained. This procedure to arrive at a product value at the lease site is sometimes referred to as a net-back procedure.

Federal royalties are based upon the value of the gas at the lease boundary. In determining the value of Kenai gas at the lease, the value at the point of sale of the LNG sold over a year's period will be reduced by an amount equal to the allowable operating costs for that year for transportation and manufacturing plus an amortization payment. The purpose of the amortization payment is to recover, together with a return on investment, the depreciable capital expenditures and development costs or other expensed costs not immediately offset by revenues. This adjusted sales value will be divided by gas volumes processed and transported accordingly; thus resulting in a sales value at the lease on a per unit (Mcf) basis.

Amortization payments for an expenditure begins the year after the expenditure is made (or later if the expenditure item is

not put into service the following year). Sales must have taken place in order to offset amortization payments and operating costs.

Capitalized items and any associated expenses are amortized over a period of time equal to the depreciation life of the equipment as reported to the IRS. Development costs and expenses associated with capital investment shall be amortized over a period of time equal to the IRS guideline class life of major capitalized petroleum plants or the class life of the equipment with which the expenses are associated.

For any given year, expenditures can occur that require different amortization lives (five years, ten years, fifteen years, etc.). The payments for these expenditures shall be according to an established amortization schedule. Expenditures made in the same year and with the same amortization life shall be grouped together for purposes of making the amortization calculation. Each year new expenditures might be made and new amortization payments added while old amortization schedules expire and their payments drop. The total amortization payment for a computation year is the sum of all active amortization payments.

Allowable Capital Investment Costs

Allowable investment costs are generally those expenditures for fixed assets (including delivery and installation costs) that are directly associated with the liquefaction and transportation of the Kenai field gas. Allowable capital investment costs shall include those expenditures for fixed assets that are directly associated with transporting the natural gas from the gas field to the liquefaction plant, manufacturing the LNG, and transporting the LNG from the liquefaction plant to the point of sale.

The items listed below are generally considered as allowable capital investment costs:

Plant and office buildings; warehouses; shops; laboratories; sidewalks; fences; plant roads and rights-of-way for plant roads; fresh water wells and supply systems; pipeline systems; LNG tankering systems; general plant facilities such as heat and steam, power, fuel, and sewage; all related controls, meters (including plant inlet and sales meters), pipe valves, and fittings; and equipment items used in the liquefaction of the natural gas, such as absorbers, heat exchangers, coolers, chillers, and compression facilities for refrigeration or recompression of gas required during manufacturing.

Allowable Operation and Maintenance Expenditures

Operation and maintenance costs, which are those nondepreciable expenditures associated with the costs of operating and maintaining the plant and transportation facilities, may include the following items:

(1) Salaries and wages paid to employees and supervisors while engaged in operating and maintaining the plant and transportation facilities.

(2) Electrical or other energy expenditures, including any gas used in liquefaction and transportation.

(3) Chemicals and lubricants used for the purpose of liquefaction, protection, or cleaning the processing and transportation facilities.

(4) Repairs, contract labor, material, and supplies directly connected to the pipeline, plant, and LNG transportation system.

(5) Insurance and taxes (Federal and State income taxes are not an allowable deduction).

(6) Rental expenditures for leasing of equipment and/or plant site.

(7) General and administrative overhead costs (telephone service, payroll taxes, employee fringe benefits,

vehicle expenses, office supplies, etc.). The total of these costs shall be limited to expenditures directly attributable and allocable to the operation and maintenance of the pipeline, plant, and LNG transportation system.

Operation and maintenance expenditures will generally be limited to those items which are reasonable and represent an integral part of the liquefaction process. Such expenditures shall be supported by copies of the invoices retained at the office which makes royalty payments to MMS. These invoices and data shall be available for audit purposes when requested by MMS.

Return on Investment

The lessee shall present to MMS a proposed reasonable rate of return for this type of operation in the Alaska region at the time covered by this project. This proposal shall identify all components such as risk, cost of capital, etc., that are incorporated in this rate. If the lessee is unable to provide convincing evidence that their proposed rate of return is reasonable, MMS will fix a value and advise Marathon of the rate of return to be used.

Non-allowable Items

Non-allowable items include the following:

(1) Gas gathering system on the leases.

(2) Compressor fuel and associated expenditures to move the gas to the Nikiski LNG plant.

(3) Raw liquid sweetening facilities.

(4) All royalty payments.

(5) Federal and State income taxes.

[Amortization Worksheet
Provided by the Agency is Omitted Here]

5. Minerals Management Service Notice Issued January 6, 1983.

[SEAL]

MINERALS MANAGEMENT SERVICE
Reston, Virginia 22081

In Reply Refer To:
MMS-Mail Stop 660

January 6, 1983

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. Al Mechler, Jr., Manager
Anchorage Division Production
Marathon Oil Company
P.O. Box 2380
Anchorage, Alaska 99510

Dear Mr. Mechler:

The Minerals Management Service hereby gives notice to the Marathon Oil Company of its intent to determine the reasonable value for computing royalties on gas produced and sold from certain Federal leases located in the Kenai Gas Field, located in Alaska, starting with the volumes produced in May of 1983. The leases in question produce gas that is shipped by pipeline to a Liquefied Natural Gas plant at Nikiski, Alaska, on the east side of the Cook Inlet. At the plant the gas is liquefied and loaded on ocean tankers for shipment to Japan for sale to Tokyo Electric Power Company and Tokyo Gas Company. Marathon has a 30 percent ownership interest in the liquified natural gas sold to these Japanese companies.

In the past, valuation of this gas in royalty calculations was based on a formula that performed a calculation to back out gas processing and transportation costs to determine the net value at the point of first sale. The basic net back valuation

theory of this formula is sound, but adjustments to the formula are necessary to reflect changing costs and prices due to economic conditions. The valuation methodology we propose for prospective royalty calculations is summarized in the attachment to this letter.

A public oral hearing on this matter with Minerals Management Service representatives will be held at 9:00 a.m. on February 15, 1983, at the MMS office in Anchorage, Alaska. The address of this office is:

Minerals Management Service
800 A Street, Suite 201
Anchorage, Alaska 99501

The Marathon Oil Company has 30 days from the date of this letter to file written comments, evidence, and legal arguments on this matter with the Minerals Management Service. Please send your comments to:

Mr. Robert E. Boldt
Associate Director for Royalty Management
Minerals Management Service
MS 660 USGS National Center
12201 Sunrise Valley Drive
Reston, Virgina 22092

At the hearing on February 15, 1983, you will have an opportunity to present your views orally to representatives of the Minerals Management Service. This action is pursuant to the regulatory authority in Title 30 of the Code of Federal Regulation, part 221.47.

Sincerely,

/s/ ROBERT E. BOLDT

Robert E. Boldt
Associate Director
Royalty Management Program

Enclosure

ENCLOSURE:

PROPOSED METHODOLOGY FOR DETERMINING THE VALUE FOR ROYALTY PURPOSES OF NATURAL GAS PRODUCED ON FEDERAL AND INDIAN LEASES IN THE KENAI GAS FIELD

The "Phillips Formula" currently used to value gas which is produced by Marathon from the Kenai Field, liquified [sic], and tankered to Japan, provides the unit value of the natural gas for royalty purposes. MMS will continue to value production using the "Phillips Formula." However, beginning in May 1983, and annually thereafter, the coefficients of the formula shall be updated to reflect current costs. The procedure for updating the coefficients involves determining the ratios of annual costs to total annual sales value and total annual sales volume respectively for the following categories:

(1) Liquifying [sic], storing, and tankering the natural gas, and

(2) Transporting the gas via pipeline from the lease to the inlet of the LNG plant.

The cost categories will consist of allowable yearly operating costs and yearly capital recovery costs, including a return* on capital and development expenditures. Capitalized ex-

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* The after tax reasonable rate of return to be used will be established by MMS. Marathon shall present to MMS a proposed reasonable rate of return for this type of operation in the Alaska region at the time covered by this project. This proposal shall identify all components such as risk, cost of capital, etc., incorporated in this rate. If Marathon is unable to provide convincing evidence as to the rate of return to be used for this project, MMS will set the rate of return at 8%. The MMS approved rate of return shall be applied in accordance with MMS procedures.

penditures to be amortized will be adjusted to account for costs recovered through salvage, tax credits, and tax advantages resulting from depreciation deductions.

The net unit value for royalty purposes will be calculated using the gross price as determined at the point of sale, operating costs, and the initial investment and development costs adjusted for additions and deletions in the expenditure categories for pipelining, liquefaction, storage, and tankering.

Ratio (1) above represents a manufacturing and transportation allowance to be deducted by Marathon from the sales value. The unit value at the point of sale shall be multiplied by the quantity, one minus ratio (1). This unit sales value is further reduced by subtracting ratio (2) to allow for pipelining costs from the lease to the LNG plant.

Marathon will be responsible for making all calculations and submitting an annual allowance proposal to the Minerals Management Service. Detailed procedures for making these calculations will be provided to Marathon by the MMS. These calculations will be subject to review and audit.

D. ORDERS CONCERNING REHEARING

1. Ninth Circuit Order Issued July 25, 1986.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARATHON OIL COMPANY, *Plaintiff-Appellant,* vs. UNITED STATES OF AMERICA, *et al.* *Defendants-Appellees.*	No. 85-3800 DC# A83-208 Civil
COOK INLET REGION, INC., *Counterclaimant,* vs. MARATHON OIL COMPANY, *Counterdefendant.*	ORDER

Appeal from the United States
District Court for the District of Alaska

Before: WALLACE, Circuit Judge.

The opinion in this case is to be temporarily withheld from publication in any bound volume, including the bound volume of Federal Reporter of West Publishing Company, until further order. A slip opinion may be circulated and the opinion may be cited.

2. Ninth Circuit Order Issued August 20, 1986.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARATHON OIL COMPANY, *Plaintiff-Appellant,* vs. UNITED STATES OF AMERICA, *et al.* *Defendants-Appellees,*	No. 85-3800 DC# A83-208 Civil
COOK INLET REGION, INC., *Counterclaimant,* vs. MARATHON OIL COMPANY, *Counterdefendant.*	ORDER

Appeal from the United States
District Court for the District of Alaska

Before: WRIGHT AND WALLACE, Circuit Judges, and LEGGE,* District Judge.

Counsel for Marathon assert that our order which temporarily withholds the case from "publication in any bound volume," and which also specifically states that the opinion may be cited, misled counsel into believing that some change may be made in the opinion. There is nothing in the order that affects

* Honorable Charles A. Legge, United States District Judge, Northern District of California, sitting by designation.

the authenticity of the opinion, and it obviously relates to whether it will be published at that time "in any bound volume."

Marathon's request for an extension of time to file a "motion for rehearing or rehearing *en banc*" until 14 days from the date an order is entered allowing the opinion to be published is denied.

3. Ninth Circuit Order Issued September 3, 1986.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARATHON OIL COMPANY, *Plaintiff-Appellant,* vs. UNITED STATES OF AMERICA, *et al.* *Defendants-Appellees.*	No. 85-3800 DC# A83-208 Civil
COOK INLET REGION, INC., *Counterclaimant,* vs. MARATHON OIL COMPANY, *Counterdefendant.*	ORDER

Appeal from the United States
District Court for the District of Alaska

Before: WRIGHT AND WALLACE, Circuit Judges, and LEGGE,* District Judge.

The motion filed by Marathon for clarification of our order dated August 20, 1986, is denied. Our order is clear.

If Marathon wishes to file a motion for leave to file a late petition for rehearing and suggestion for rehearing *en banc*, it should do so promptly with supporting papers demonstrating why such leave should be granted.

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* Honorable Charles A. Legge, United States District Judge, Northern District of California, sitting by designation.

4. Ninth Circuit Order Issued September 30, 1986.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARATHON OIL COMPANY, *Plaintiff-Appellant,* vs. UNITED STATES OF AMERICA, *et al.* *Defendants-Appellees,*	No. 85-3800 DC# A83-208 Civil
COOK INLET REGION, INC., *Counterclaimant,* vs. MARATHON OIL COMPANY, *Counterdefendant.*	ORDER

Appeal from the United States
District Court for the District of Alaska

Before: WRIGHT AND WALLACE, Circuit Judges, and LEGGE,* District Judge.

The petition for rehearing and suggestion for rehearing *en banc* lodged by Marathon Oil Company is ordered filed.

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* Honorable Charles A. Legge, United States District Judge, Northern District of California, sitting by designation.

5. Ninth Circuit Order Issued September 30, 1986.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARATHON OIL COMPANY, *Plaintiff-Appellant,* vs. UNITED STATES OF AMERICA, *et al.* *Defendants-Appellees.*	No. 85-3800 DC# A83-208 Civil
COOK INLET REGION, INC., *Counterclaimant,* vs. MARATHON OIL COMPANY, *Counterdefendant.*	ORDER

Appeal from the United States
District Court for the District of Alaska

Before: WRIGHT AND WALLACE, Circuit Judges, and LEGGE,* District Judge.

The government is requested to file within twenty-one (21) days from the date of this order a response of not over fourteen (14) pages to the petition for rehearing and suggestion for rehearing *en banc* of Marathon Oil Company. The response should be directed to part I of the petition. The government should include its position as to the sufficiency of the administrative record in general, and in support of any finding that liquid natural gas is equivalent to natural gas, whether this issue was properly raised and preserved in the district court, and whether it was properly raised on this appeal. Proper citations to the record should be included.

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* Honorable Charles A. Legge, United States District Judge, Northern District of California, sitting by designation.

6. Ninth Circuit Order Issued November 13, 1986.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARATHON OIL COMPANY, *Plaintiff-Appellant,* vs. UNITED STATES OF AMERICA, *et al.* *Defendants-Appellees.*	)	No. 85-3800 DC# A83-208 Civil
COOK INLET REGION, INC., *Counterclaimant,* vs. MARATHON OIL COMPANY, *Counterdefendant.*	)	ORDER

Before: WRIGHT AND WALLACE, Circuit Judges, and LEGGE,* District Judge.

Appellant's reply to the response of the United States to the petition for rehearing and suggestion for rehearing *en banc*, already received, shall be filed.

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* Honorable Charles A. Legge, United States District Judge, Northern District of California, sitting by designation.